

The Parliament of the Commonwealth of Australia

**JAPAN'S ECONOMY
IMPLICATIONS FOR
AUSTRALIA**

**REPORT 1
OF THE
SENATE FOREIGN AFFAIRS, DEFENCE AND TRADE
REFERENCES COMMITTEE**

AUGUST 2000

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TERMS OF REFERENCE

That the following matter be referred to the Senate Foreign Affairs, Defence and Trade References Committee for inquiry and report to the Senate:

- (1) Examination of developments in contemporary Japan with respect to:
 - (a) contemporary economic conditions, including:
 - (i) the impact of low and expected continuing low growth;
 - (ii) the effect of the Asian currency crisis;
 - (iii) blockages to economic efficiency and areas of reform in the domestic economy; and
 - (iv) trading patterns and the significance of Japan's growing trade surplus in its relations with its leading trading partners;
 - (b) contemporary political changes, including:
 - (i) the changes in the major political parties, the emergence of new parties and the electoral and structural changes that are occurring;
 - (ii) the political significance and power of land-holders and farmers in influencing social and economic progress; and
 - (iii) Japan's view of itself in the world and its role in the Asian region;
 - (c) significant contemporary changes in Japanese society;
- (2) examination of the implications of the above matter for Australia.

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CHAPTER 1

INTRODUCTION

Establishment of the inquiry

1.1 Over many decades, Australia and Japan have forged a close and mutually beneficial friendship. In 1957, they signed a Commerce Agreement, which laid solid foundations on which both countries have built a fruitful and deepening partnership. Twenty years on, the Prime Ministers of Australia and Japan, wishing to place their relations on an even closer and more concrete basis, signed a treaty of friendship.

1.2 Both countries also appreciate their important role in the Asia Pacific region and have a shared desire to see the region prosper. For many years, Australian and Japanese political leaders, academics and business people have worked together with those from the developing nations in the region to foster economic cooperation and to facilitate social progress throughout the Pacific.

1.3 Today, the partnership between Australia and Japan still stands firm but there are challenges ahead for both countries in further developing their relationship. Social and economic changes in Japan, the Asian economic crisis and a dramatically changing global landscape mean that Australia and Japan cannot take their strong and long-lasting relationship for granted. The time is ripe for a review of Australia's relationship with Japan.

1.4 On 31 March 1998, the Senate referred the following matter to the Senate Foreign Affairs, Defence and Trade References Committee for inquiry and report by February 1999:

- (1) Examination of developments in contemporary Japan with respect to:
 - (a) contemporary economic conditions, including:
 - (i) the impact of low and expected continuing low growth;
 - (ii) the effect of the Asian currency crisis;
 - (iii) blockages to economic efficiency and areas of reform in the domestic economy; and
 - (iv) trading patterns and the significance of Japan's growing trade surplus in its relations with its leading trading partners;
 - (b) contemporary political changes, including:

- (i) the changes in the major political parties, the emergence of new parties and the electoral and structural changes that are occurring;
 - (ii) the political significance and power of land-holders and farmers in influencing social and economic progress; and
 - (iii) Japan's view of itself in the world and its role in the Asian region;
- (c) significant contemporary changes in Japanese society;
- (2) examination of the implications of the above matter for Australia.

The reporting date was subsequently extended to 17 August 2000.

Conduct of the inquiry

1.5 The Committee advertised the inquiry in all Australian capital cities and in the *Australian Financial Review* on 8 April 1998 and in the *Australian* on 11 April 1998. The advertisement called for written submissions to be lodged by 12 June 1998. In addition, the Committee wrote to parties with interests or particular expertise in Japanese affairs drawing attention to the inquiry and inviting submissions. In all, the Committee received 64 submissions, details of which are listed in Appendix 1. All of the written submissions were made public documents.

1.6 Public hearings were held in Canberra, Melbourne, Perth, Sydney and Brisbane over a period of seven months from February to September 1999. Witnesses were drawn from federal and state government departments, Australian and Japanese businesses, journalism and academia. Details of these hearings together with a witness list are contained in Appendix 2. His Excellency, Mr Masaji Takahashi, Ambassador of Japan, and Mr Kiyokazu Ota, Minister, Embassy of Japan, kindly accepted the Committee's invitation to appear before it on 30 August 1999. This hearing took place *in camera*.

The Structure of the report

1.7 Because of the wide-ranging nature of the inquiry, the Committee decided that the report would be divided into two separate parts. This report—*Japan's Economy: Implications for Australia*—forms Part One and deals specifically with the contemporary economic developments in Japan and their implications for Australia. The second part will deal with the contemporary political, social and cultural changes in Japan and how they affect Australia.

Acknowledgments

1.8 The Committee wishes to express its appreciation to everyone who contributed to the inquiry by making submissions, providing information or appearing before the Committee at public hearings. The Committee would like to extend a

special thanks to Ambassador Masaji Takahashi, Mr Kiyokazu Ota and the staff at the Japanese Embassy in Canberra for their interest and invaluable assistance throughout the inquiry.

JAPAN



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0 kilometres 200

Asia Pacific Region



CHAPTER 2

NATURAL PARTNERS

2.1 Japan stands prominently on the world economic stage in the Asia Pacific region. It is the world's second largest economy after the US, the world's largest individual national commodity importer, the world's leading creditor nation and it has one of the highest per capita incomes and the highest savings rate in the world. Aside from its global significance, Japan is of primary importance to Australia.¹

Japan and Australia

2.2 Australia's commercial links with Japan span many generations. Over the years, and even as Japan emerged as a new and dominant global economic force, this relationship has matured and deepened into a mutually beneficial partnership.

2.3 In 1947, Australia referred to Japan as a natural market.² This theme has evolved over the years into a notion of partnership that is now central to the understanding of the Australia-Japan relationship. Past and present leaders of both countries have found no difficulty in applying the term partnership to the Australia-Japan relationship. They have spoken openly of a close friendship, of enjoying a rich and diverse relationship and of the spirit of trust that underpins this relationship.³ Readily they have acknowledged their common concerns, shared policy objectives, mutual interests and the complementarity in trade.⁴ Both countries have made a firm commitment to freedom and democracy, and expressed their desire to work together to achieve joint objectives especially promoting the economic prosperity of their region. The partnership has been described as 'close', 'constructive' even 'indispensable'.⁵

2.4 In May 1995, the Prime Ministers of Australia and Japan reflected on this 'relationship of unprecedented quality' and in a joint declaration reaffirmed the importance they place on the close relationship of goodwill and cooperation that Australia and Japan have forged over the post-war years. They pledged to build on that foundation 'an enduring and steadfast partnership'.

1 For example see: ABARE, submission no. 21, p. 6; DFAT, submission no. 32, pp. 5-7.

2 See chapter 5, para 5.17.

3 Gareth Evans, 'Australia and Japan: Old Friends, New Challenges, Speech to the 19th Australia-Japan Relations Symposium, 24 February 1995.

4 For example see: Speech of Prime Minister Hashimoto at the dinner hosted by Prime Minister Howard and Mrs Howard, 'Australia and Japan in the Asia Pacific Region', 28 April 1997; Speech of Japanese Ambassador, Yukio Satoh at the Foreign Correspondents' Association in Sydney, 'Japan-Australia Relations': Emerging Partnership, 1 November 1996.

5 'Partnership Agenda between Australia and Japan', Ministry of Foreign Affairs, Japan, <http://www.mofa.go.jp/region/asia-paci/australia/agenda.html> (5 November 1999).

2.5 In August 1997, Australia and Japan formalised a new Partnership Agenda which ‘recognised the breadth of the links and exchanges at all walks of life between Australia and Japan’. The Agenda sought to promote deeper mutual understanding and cooperation across a diverse range of shared interests. It acknowledged the strong commercial ties between the two countries and gave a commitment to build on the complementarity and growing diversification of their trade.⁶

2.6 Despite such warm and encouraging words and the strong complementarity in trade that binds Australia and Japan, it is essential for the two countries to guard against complacency. Many witnesses believe that if the relationship is to continue to benefit both countries and indeed the region, it will need to be nurtured and tended.

2.7 Mr Leon Wolff, a law lecturer and research fellow at the Australia-Japan Research Centre, ANU, regarded this inquiry as timely not because Australians have neglected Japan but rather Australians have enjoyed such a comfortable relationship with Japan. The Committee notes that there are tensions, however, in the relationship that should not be ignored, disagreements that need to be managed and adjustments to be made as changes occur within both countries and globally. Many witnesses recognised that the challenge for both countries is to maintain and cultivate this relationship in an environment of economic change, uncertainties and insecurities. The partnership will have to embrace a much wider range of economic exchanges and it must grow in sophistication and depth. According to Mr Wolff, it is time to consider what is happening within Australia and, more particularly, in Japan.

2.8 The Committee believes that this inquiry provides a good opportunity to take stock of the relationship between Australia and Japan and to consider its future—‘how we can go to the next step and tighten the bonds that exist between us’.⁷

2.9 A number of witnesses, particularly those who have worked in Japan and closely with the Japanese people, speak of the depth of this relationship which has been fostered over many years of close association and cooperation.⁸ Despite the majority view that the relationship between Australia and Japan rests on a solid footing of goodwill and mutual benefit, some witnesses were apprehensive that this strong and robust relationship nurtured by successive governments ‘looks set to fracture due to current economic conditions in Japan’.⁹

2.10 Warm rhetoric can mask or even deny underlying tensions or disjunctions in a relationship; it can certainly gloss over problems. In 1997, Japan’s Ambassador to Australia, Mr Yukio Satoh, suggested that for all the talk of partnership at the level of public opinion, the peoples from each of these two countries seem to regard the other

6 Partnership Agenda between Australia and Japan, The Ministry of Foreign Affairs of Japan, <http://www.mofa.go.jp/region/asia-paci/australia/agenda.html> (5 November 1999).

7 Leon Wolff, *Committee Hansard*, 28 May 1999, p. 650.

8 Manuel Panagiotopoulos, *Committee Hansard*, 14 April 1999, p. 219.

9 Mr Bradley Treadwell, Managing Director, Osborne Associates, submission no. 8, p. 3.

as citizens of a 'distant country'. He argued that 'the future task of the governments of Japan and Australia is to realise a state of relations where the peoples of both countries speak of Japan-Australia partnership with a sense of reality'.¹⁰

2.11 One witness went further to state that the Australia-Japan relationship is 'currently as dead as a dodo...a relationship that is floundering'. Mr Bradley Treadwell, Managing Director, Osborne Associates, told the Committee that the deterioration in the Australia-Japan relationship was not only at government level but also at business, private sector and cultural levels. He submitted:

I cannot see one layer in the Australia-Japan relationship which is presently growing, developing or opening up new vistas for interchange, cultural diversity and growth in business development.¹¹

2.12 In his opinion, the reverse was happening with waves of Japanese investment and other interactions receding. This disintegration was not a one-sided affair and he called urgently for a re-invigoration of the relationship.¹² He cited poor media reporting and the apparent cutting back of forums that have hitherto existed in the Australia-Japan relationship such as the 'very vibrant Australia-Japan economic institute in Sydney' as evidence of a tired relationship. He suggested that a continuing focus on the Australia-Japan relationship would be a vital facilitation role for government.¹³

2.13 Undoubtedly for Australia and Japan, there is a growing need to manage an increasingly diverse relationship under conditions of rapid technological advancement, a changing global economic system and international uncertainty. Both countries have to adjust to, and foster their relationship in, an environment of shifting power structures, tensions between major trading partners and economic insecurities—fault lines are appearing in the trading links between the US and Japan, China is emerging as an economic force, and there is the aftermath of the Asian economic crisis. There are the uncertainties generated by globalisation, the push for trade liberalisation, and uneasy rumblings from within the WTO process. Moreover, Japan itself is undergoing fundamental change with a comprehensive program of reform, severe demographic shifts such as its rapidly ageing population, and a restructuring and reorientation of its economic system.

10 Yukio Satoh, Ambassador of Japan to Australia, *SDSC Working Papers*, Working Paper No. 312, 'From Distant Countries to Partners: the Japan-Australian Relationship, Strategic and Defence Studies Centre, ANU, Canberra, November 1997, p. 1. This paper represents the personal views of the author.

11 Bradley Treadwell, Managing Director Osborne Associates, *Committee Hansard*, 19 February 1999, p. 62.

12 Bradley Treadwell, Managing Director Osborne Associates, *Committee Hansard*, 19 February 1999, p. 62.

13 Bradley Treadwell, Managing Director Osborne Associates, *Committee Hansard*, 19 February 1999, pp. 71–72.

2.14 The Committee's inquiry was conducted while all these developments were taking place. In this report, the Committee at first deals with developments in contemporary Japan especially in light of the economic downturn in Japan. It then turns to the Australia-Japan relationship. It briefly sketches the evolution of Australia's trading links with Japan to provide some understanding of the foundations upon which the Australia-Japan relationship stands. The Committee then focuses on recent developments in the Australia-Japan relationship. It looks at the effects of Japan's economic troubles on Australia's trading links with Japan, the opportunities opening up in Japan for Australian business despite the economic recession and the steps Australia can take to improve its commercial ties with Japan. Finally, the Committee broadens the scope of the inquiry and places the Australia-Japan trading links within the broader Asia commercial trading network. It also looks at Japan's trading relationship with the United States.

CHAPTER 3

JAPAN—ON THE THRESHOLD OF A NEW MILLENIUM

Japan now faces the greatest national crisis in its post-war history.

Taichi Sakaiya, December 1998¹

Postwar Japan

3.1 In this chapter, the Committee traces the course of events that led to Japan's economic boom in the late 1980s, its collapse in the early 1990s and then the country's struggle through the remaining years of the decade to find the direction and drive that would take it into the 21st century.

3.2 The unconditional surrender of Japan in World War II left it a devastated country occupied by foreign forces determined to redefine and shape its society and economy. After two years of 'democratisation' and the dismantling of Japan's prewar economy, America's policy toward Japan softened and the bureaucratic managers of Japan's 1940s controlled economy were allowed to regroup and once again take charge of Japan's economic destiny.

3.3 Under their guidance, the Japanese people faced the daunting task of rebuilding their nation from the ruins of war. With renewed vigour and strength of purpose, they began the process of reconstruction. Led by stable government and nestling under the American security blanket, the Japanese people concentrated their energies on, and devoted their resources to, economic growth. Over the next forty years, Japan not only attained its goal of catching up with the West but, by adding economic success to economic success, earned its place in the world as the second largest economy.

3.4 The engine driving this transformation relied on a highly regulated society characterised by firm bureaucratic intervention 'in all facets of corporate and consumer activity'.² The extent of discretion allowed to the bureaucracy with its strong grip on economic development was indeed one of the defining features of the Japanese system of administration. According to economist, Mr Nukazawa Kazuo:

Public servants in postwar Japan acted as protectors of egalitarianism. In areas ranging from the establishment of bank branches to the siting of oil

1 Taichi Sakaiya, 'Japan is Changing', *Japan Echo*, vol. 25, no. 6, December 1998, p. 34.

2 See Isao Nakauchi, 'Corporate Efforts to Promote Deregulation', Text of Speech given by Mr Isao Nakauchi, Vice Chairman of Keidanren, at the Foreign Correspondents' Club of Japan, 19 September 1994. Dr Aurelia George Mulgan, submission no. 20, p. 10.

refineries, the bureaucracy took over planning and adjustment functions instead of leaving them to the market. Basically the public supported this.³

3.5 This tightly managed economic system, known as the ‘catch-up’ model, combined with a well-disciplined and highly motivated workforce to promote economic development. Moreover, the ready supply of investment funds available at artificially low interest rates, due to the country’s high savings rate and a regulated interest rate regime, provided generous support for industry.

3.6 The Japanese people willingly accepted government intervention in the financial system which offered them both stability and economic security. Although Japanese savers bore most of the costs because of the low returns on their deposits and the lack of alternative financial institutions, they could see their savings contributing to the rapid economic development of the country. Their ‘reward was in wage increases, not interest yields on savings’.⁴

3.7 Also, from the 1960s, large industrial conglomerates known as ‘keiretsu’ formed in Japan. They tended to centre on leading banks and each fostered the development of its own general trading companies and general contractors and, over time, built up a large nexus of affiliated firms. Thus, according to Minister Taichi Sakaiya:

Japan’s industrial organization became characterized by the cooperative horizontal linkages in coordination of industries formed under bureaucratic guidance, and vertical ‘keiretsu’ linkages with financial institutions or large enterprises at the core.⁵

1980s—Bubble economy

3.8 Throughout the 1970s and 1980s, the Japanese economy grew steadily despite the negative impact of the two oil-price shocks in the 1970s when Japan’s real GDP growth averaged 4.4%.⁶ By the middle of the 1980s, Japan’s economy started to boom, asset prices rose dramatically with equity and land prices increasing threefold.⁷ Although improved economic fundamentals contributed to this increase in equity prices, the combination of financial liberalisation, an inadequate prudential regulatory

3 Nukazawa Kazuo, ‘The Japanese Economy: From World War II to the New Century’, *Japan Echo*, vol. 25, no. 2, April 1998.

4 Hugh Patrick, ‘The Causes of Japan’s Financial Crisis’, *Pacific Economic Paper*, no. 288, Australia-Japan Research Centre, February 1999, p. 1.7.

5 Taichi Sakaiya, Minister of State Economic Planning Agency, ‘The Present and Future of the Japanese Economy’, Speech at Yale University, May 2000, <http://www.epa.jp/2000/b/0505b-daijinkouen-e.html> (5 July 2000).

6 DFAT, submission no. 32, pp. 7–8.

7 IMF, *World Economic Outlook*, Chapter IV, ‘Japan’s Economic Crisis and Policy Options’, IMF, 1998, p. 108.

regime and relaxed monetary policy also had a key role in the sharp increase in asset prices.⁸

3.9 Thus banks and other finance institutions, operating under lax lending rules and without adequate accounting procedures in place, provided imprudent levels of credit to real estate and equity markets to compensate for falling profit margins and shrinking market shares.⁹ This increased lending to the property sector fuelled the boom in commercial and residential property prices.¹⁰ Monetary policy, notably low interest rates, at this time further encouraged the rise in asset prices. Speculative money poured into the property market and the banks continued to lend assuming that economic growth and asset-price rises would continue.¹¹ According to Mr Thomas Cargill et al:

...at some point, probably in late 1986 or 1987, the asset inflation process appeared to become a speculative bubble with little restraint either from financial institutions or the regulatory authorities. Expectations of asset price increases fed upon themselves and price/dividend and price/rent ratios increasingly deviated from fundamental values until the crash in the early 1990s. Speculators during the asset inflation typically thought that even though the 'levels' of stock and land prices were abnormally high and would eventually fall, further investment was warranted as long as other investors thought prices would continue to rise. Many felt that they would be among the first to sell their asset holdings, realizing large capital gains, when the market started to fall.¹²

1990—collapse of the bubble economy

3.10 By the close of the decade, the bubble economy was showing signs of distress and there were worrying indications that it was in serious difficulties. The speculative bubble, built on shallow foundations and inflated hopes, was about to collapse.

3.11 Japanese authorities, aware of the overheated economy and the rising asset prices, had begun to tighten monetary policy. Some analysts have argued that the Bank of Japan should have stepped in much earlier to tighten the money supply.¹³ The

8 IMF, *World Economic Outlook*, Chapter IV, 'Japan's Economic Crisis and Policy Options', IMF, 1998; pp. 108–9; Hugh Patrick, 'The Causes of Japan's Financial Crises', *Pacific Economic Paper no. 288*, *Japan's Financial Reform*, Australia-Japan Research Centre, February, 1999, p. 1.11.

9 Thomas Cargill, Michael Hutchison and Takatoshi Ito, 'Japanese Deregulation: What you should know', Japan Information Access Project, <http://www.nmjc.org/jiap/deregulate/papers/deregcon/hutchison.html> (1 March 1999).

10 IMF, *World Economic Outlook*, Chapter IV, 'Japan's Economic Crisis and Policy Options', IMF, 1998, p. 109.

11 See Mr Charles Wensley, Hamersley Iron Pty Ltd, *Committee Hansard*, 24 February 1999, p. 96.

12 Thomas Cargill, Michael Hutchison and Takatoshi Ito, 'Japanese Deregulation: What you should know', Japan Information Access Project.

13 Hugh Patrick; 'The Causes of Japan's Financial Crisis', *Pacific economic Papers no. 288*, February 1999, p. 1.13; Ogata Shijuro, 'Three Proposals for Japan's Troubled Central Bank', *Japan Echo*, June 1998, p.

official discount rate rose 3.5 percentage points in just over 12 months until it reached 6% in August 1990.¹⁴ Equity prices began to tumble and by the time they had flattened out in mid-1992, the Nikkei index had fallen by over 60% from its height at the end of 1989.¹⁵ Land prices followed in early 1991 and have continued to fall steadily. According to the IMF, the average price of land in the six largest Japanese cities at the end of 1997 stood at about 40% of peak values in 1990.¹⁶

3.12 Investment, which had also grown significantly during the boom period, fell markedly as asset prices plunged and firms found themselves ‘saddled with investment overhang from the late 1980s and returns to capital dropped’.¹⁷

3.13 Businesses that had borrowed heavily saw the value of their assets depreciate sharply while debts such as bank loans still carried their original value producing a widening gap between assets and liabilities. Financial institutions found a similar imbalance as parts of their corporate lendings became non-performing. Thus, firms and financial institutions suffered a substantial deterioration in their real capital base.¹⁸ Economist, Mr Richard C. Koo, termed this the ‘balance sheet recession’.¹⁹

3.14 Minister Taichi Sakaiya underlined the magnitude of the problem when he pointed out that in 1980 the total outstanding loans of all Japanese financial institutions amounted to 56.8% of GDP, whereas ten years later this ratio had risen to 103.1% of GDP—over a 45 percentage point increase in the relative size of lending.²⁰ Overall, the fall in asset values seriously undermined the profitability of Japan’s financial institutions, generated uncertainty in the market, weakened consumer demand, lowered sales and profits for the corporate sector, tightened the availability of credit and precipitated a protracted economic slowdown.

3.15 With the economy now struggling to climb out of trouble and consumer confidence crumbling, the economic outlook during the early 1990s was turning increasingly bleak. The growth rate of GDP for fiscal 1993 was 0.0% (-0.1% for

27; Adam S. Posen, *Restoring Japan’s Economic Growth*, Institute for International Economics, Washington, 1998.

14 IMF, *World Economic Outlook*, October 1998, Chapter IV ‘Japan’s Economic Crisis and Policy Options’, IMF, 1998, p. 110.

15 IMF, *World Economic Outlook*, October 1998, Chapter IV ‘Japan’s Economic Crisis and Policy Options’, IMF, 1998, p. 110.

16 IMF, *World Economic Outlook*, October 1998, Chapter IV ‘Japan’s Economic Crisis and Policy Options’, IMF, 1998, p. 110.

17 IMF, *World Economic Outlook*, October 1998, Chapter IV ‘Japan’s Economic Crisis and Policy Options’, IMF 1998, p. 111.

18 Masaru Hayami, Governor of the Bank of Japan, Speech to the Yomiuri International Economic Society in Tokyo, 29 July 1998.

19 Richard C. Koo, ‘Is Japan Misunderstood’, Remarks of Richard C. Koo, Chief Economist, Nomura Research Institute at the Economic Strategy Institute, 13 July 1998.

20 Speech by Minister Taichi Sakaiya, Sorbonne University, Paris, 7 January 1999, <http://www.epa.go.jp/99/b/19990107b-daijinkouen-e.html> (24 April 1999).

GNP) which fell short of forecasts; the initial government prediction, measured on a GNP basis, was 3.3% and the average forecast by private research institutions was in the 'latter half of 2%'.²¹

Response to economic downturn

3.16 The Japanese Government took a number of steps to resuscitate the economy. On four separate occasions between August 1992 and mid-1995, it put in place packages of fiscal stimulation measures valued at a total of 45 trillion yen to bolster the growth rate. It also adopted two supplementary budget packages involving the disbursement of 2.3 trillion yen in FY 1994, and reduced income taxes by 6 trillion yen for FY 1995.²² But the trillions of yen used to boost economic activity, especially the funds poured into public works, failed to return the Japanese economy to robust health.

3.17 The government also hoped that reform of the economic system would revive Japan's economy and set it on a growth path. For almost two decades Japan, in keeping with global trends, had been moving toward administrative and economic reform but the process had been piecemeal and faltering. During the early 1990s, the Japanese Government implemented a number of reform initiatives especially in the area of deregulation. During 1993 and 1994, three cabinet decisions led to agreement to act on over 1,100 individual deregulatory measures and administrative tools.²³

3.18 But as the economy showed no signs of rallying, attention focused more intently on the long-term and structural issues in the Japanese economy. At first, the collapse of the bubble economy was attributed to the economic cycle but as the economy failed stubbornly to rebound analysts raised doubts about the structure of the economy which increasingly came under close and searching scrutiny. According to the Japanese Economic Planning Agency '...the sluggish economy has made the structural issues, which were masked by the domestic-oriented high growth during the bubble era, stand out more sharply'.²⁴

3.19 Some commentators argued that serious and comprehensive reform was crucial to economic recovery. They saw Japan's economic system as outmoded: that the regulations, rules and practices that had become such a fixed and positive feature of the system were now obsolete. For them the system had outlived its usefulness:

21 Economic Survey of Japan (1993–1994), 'A Challenge to New Frontiers Beyond the Severe Adjustment Process', Economic Planning Agency, Government of Japan, 26 July 1994.

22 An Outline of Emergency Measures for Yen Appreciation and the Economy, <http://www.epa.go.jp/taisaku/taisaku-eng-summary.html> (19 May 1999).

23 APEC, Deregulation Report 1997, Japan, <http://www.apecsec.org.sg/deregulation/Japan.html> (18 October 1999); Summary of the 1996 Annual Report of Management and Coordination Agency, 1996.

24 Economic Survey of Japan, 1993–1994, 'A Challenge to New Frontiers Beyond the Severe Adjustment Process', Summary, 26 July 1994, Economic Planning Agency, The Government of Japan.

Like machines, however, systems have finite lives, and the present one seems to be terminally fatigued, making fundamental reform essential.²⁵

3.20 The call for Japan to overhaul its 50-year old economic system grew louder. The 1940 financial system or the ‘catch-up’ model, the bedrock of Japan’s postwar recovery and economic prosperity, seemed unable to meet the challenges of the 1990s. Previously, it had been able to gather savings efficiently from the Japanese people and to direct their funds into a controlled system; it had kept interest rates artificially low; and it had channelled these savings into selected priority industries particularly the heavy and manufacturing goods sector such as steel, machine tools, automotives, shipbuilding and electronics. These strategic industries with easy access to a substantial pool of cheap money enjoyed a distinct competitive edge. A favourable exchange rate further helped exporters.

3.21 According to Mr Peter Hartcher, an economic journalist, ‘A virtuous cycle took hold. The workers continued to bank their money at low interest rates, the system continued to funnel their money into chosen industries and these priority industries continued to add more and more productive capacity.’²⁶

3.22 This phenomenon of massive saving and investment in the private sector had a parallel in the public sector. Japanese households, with their propensity to save a large proportion of their earnings, placed these savings in postal savings accounts. The postal savings system, regulated by the Ministry of Posts and Telecommunications, directed vast volumes of low-cost capital into the so-called ‘zaito’ system, the government’s fiscal investment and loan program, often referred to as Japan’s ‘second budget’. This program, drawing on the post-office savings as a source of cheap loans, ploughed these funds into targeted industries.²⁷

3.23 This policy of favouring savings and investment over consumption—where the producer-supplier took priority at the expense of the consumer—created an environment that enabled Japan to emerge as a leading manufacturing nation. History documents the outstanding successes of this model.²⁸ The ‘production first’ and anti-competition principles embodied in this system grew stronger during the postwar

25 Fujiwara Sakuya, ‘Japan’s Financial Woes and the Hopes for Big Bang’, in *Japan Echo*, February 1998, p. 7.

26 Peter Hartcher, ‘Can Japan Come Back?’ in the *National Interest*, Winter 1998/99, pp. 32–9 in Peter Hartcher, submission no. 36, p. 36.

27 Ms Tessa Morris-Suzuki, submission no. 3, p. 2; Takatoshi Ito, ‘Japan’s Financial Crisis: Resemblances with East Asia’, *Pacific Economic Papers* no. 288, vol I, Australia-Japan Research Centre, February 1999, p. 2.15; The Economist Intelligence Unit Ltd, *EIU Report*, 1st Quarter 1996, pp. 19–20; Professor Noriyasu Watanabe, ‘Occupational Pension Systems in Japan’, *Japan Labor Bulletin*, vol. 37, no. 8, August 1998.

28 See Peter Hartcher, *Committee Hansard*, 15 April 1999, pp. 325–6; Noguchi Yukio, ‘The Persistence of the 1940 Setup’, *Japan Echo*, vol. 24, Special Issue, 1997.

period of dynamic economic growth, eventually ‘achieving the status of values in their own right’.²⁹ But times were changing as Minister Taichi Sakaiya surmised:

As compared to the American and European experience, perhaps Japan was simply too successful in industrialization. We had erected a meticulously ordered industrial society, and there was little reason to doubt the wisdom of continued dependence on manufacturing industries based on standardized mass-production approaches. So, you can imagine our disappointment when we saw the world moving away from the industrialised society and toward the new paradigm of knowledge-value society?³⁰

3.24 As the 1990s progressed, there was a growing recognition, especially among the more competitive export sectors of the business community in Japan, that public regulations frustrated economic progress; that they made the economy less flexible, less able to adapt to a changing economic environment and, overall, stymied future development.³¹ The government was beginning to realise that the reform measures initiated so far were inadequate to accommodate the changing economic environment and that a greater effort was required to push ahead with reform especially deregulation.

3.25 In July 1994, the then Prime Minister Tomiichi Murayama told the Diet that it was imperative that Japan take a long, hard look at its various regulations and determine whether they were effective or not. He stated his resolve to go beyond measures already planned and to draw up a five-year deregulation action plan. This initiative would introduce further deregulation that would, for example, encourage the entry of business into new fields of enterprise and enhance Japanese purchasing power by reducing the price differentials between Japan and overseas.³²

3.26 Nine months later, on 31 March 1995, the government decided on a ‘Deregulation Action Programme’ covering a five year period from 1995 to 1999. In formulating this program, the government identified 1,091 items for attention in 11 areas. The package was to be reviewed and updated every year.³³

29 Noguchi Yukio, ‘The Persistence of the 1940 Setup’, *Japan Echo*, vol. 24, Special Issue, 1997.

30 Speech by Minister Taichi Sakaiya, Sorbonne University, Paris, 7 January 1999. See also Ms Tessa Morris-Suzuki, submission no. 3, p. 2.

31 Economic Survey of Japan, 1993–1994, A Challenge to New Frontiers Beyond the Severe Adjustment Process, Summary, 26 July 1994, Economic Planning Agency. See also Dr Aurelia George Mulgan, submission no. 20.

32 Policy Speech by Prime Minister Tomiichi Murayama to the 130th Session of the Diet, 18 July 1994, <http://www.kantei.go.jp/foreign/130.html>.

33 Ryutaro Hashimoto, Minister of International Trade and Industry, ‘Challenges for the World Economy in a Transitional Period and Development in the Asia-Pacific Region’, Vancouver, 2 May 1995, <http://www.jef.or.jp/news/challenge.html> (19 October 1998). WTO Trade Policy Review of Japan (1998), 20 November 1998; JETRO, *The Changing Service Industries of Japan*, Tokyo, 2000, p. iii.

Emergency measures for yen appreciation and the economy—April 1995

3.27 As the economy limped toward the summer of 1995, the government became increasingly worried that the rapid appreciation of the yen from the beginning of March 1995 together with the depreciation of the United States dollar would hurt the Japanese economy over the short as well as the medium term.³⁴ Indeed, there were fears that the economy would slide into recession. In light of this mounting concern about the changes in the exchange rate and the emerging sense of uncertainty about the state of the Japanese economy, the government, in April 1995, decided upon a rescue package—the ‘Emergency Measures for Yen Appreciation and the Economy’. Under this initiative, it again resorted to injecting large sums of money into the economy in the hope that it would reignite activity.³⁵

3.28 The government reasoned that a drastic impetus to domestic demand would ‘steer the economy on a steady recovery path through dispelling feelings of uncertainty concerning the economy, enhancing the sentiment of consumers and entrepreneurs, and inspiring consumption and investment’. To this end, the government explained that ‘the largest amounts of public investment has been secured, and is planned to be implemented effectively; priority investment will be carried out to cope with the current economic and social situations’.³⁶

3.29 The Emergency Measures for Yen Appreciation and the Economy, worth over 14 trillion yen, included among its government expenditure program 3,900 billion yen to be spent on general public works and 700 billion yen on reconstruction projects in disaster areas. Public works that had already been decided upon would be actively implemented. In their expanded public works program, the government was to give priority to science and technology, information and communication and efficient land use.³⁷ Measures were also included to improve educational and welfare programs.³⁸

3.30 The Emergency Measures looked not only to fiscal policy but to accelerated structural reform to lift the economy out of the doldrums. Despite the reform measures already in place, the call for decisive reform was growing stronger. Mr Ryutaro

34 An Outline of Emergency Measures for Yen Appreciation and the Economy, <http://www.epa.go.jp/taisaku/taisaku-eng-summary.html> (19 May 1999).

35 Economic Measures: toward steady economic recovery’ (provisional translation), Ministerial Conference for Economic Measures, Government of Japan, 20 September 1995, http://www.epa.go.jp/taisaku/measures95_9 (30 March 1999).

36 Economic Measures: toward steady economic recovery’ (provisional translation), Ministerial Conference for Economic Measures, Government of Japan, 20 September 1995, http://www.epa.go.jp/taisaku/measures95_9 (30 March 1999).

37 MITI, ‘Economic Measures: (toward steady economic recovery)’, Government of Japan, 20 September 1995.

38 MITI, ‘Economic Measures: (toward steady economic recovery)’, Government of Japan, 20 September 1995; Emergency Measures for Yen Appreciation and the Economy, 14 April 1995, Ministerial Conference on Economic Measures.

Hashimoto, Minister of MITI, in a now familiar refrain, urged Japan to cast off its weary and moribund structures and practices of the past. He noted:

The social and economic system that has enabled Japan to catch up with the advanced nations of the West since the end of the Second World War has now reached a state of what may be called institutional fatigue. It has failed to adjust itself to the realities of the new global economy where corporations compete in a single global market. In consequence, there is a sense of slow suffocation, a sense of marked loss of vitality, throughout the domestic economy.³⁹

3.31 In underlining the need for prompt and decisive action, Mr Hashimoto stressed that it was ‘a matter of immediate and crucial importance for Japan to carry out domestic regulatory reform designed to turn Japan into an attractive business environment’.⁴⁰ For him, deregulation held the key to the rejuvenation of his country’s economic system. It would, he reasoned, create new markets and employment opportunities and expand the range of options available for the consumer.⁴¹

3.32 Overall, the Emergency Measures, were to put in place structural reforms to promote the mid-term and long-term development of the economy. These measures, were designed to expand the economic frontiers, promote research and development (R&D), improve the information system and, through deregulation, facilitate imports and inward investment. They would pave the way for economic growth.⁴² One aspect singled out for particular attention was the need to work toward the international harmonization of the business environment.

3.33 Under these Emergency Measures the scope of reform was not only broadened but also the process of deregulation was to be hastened. The five-year deregulation program, agreed to 12 months earlier, was to be advanced and implemented as a three-year program.⁴³

3.34 Keidanren (Federation of Economic Organizations), one of the most influential peak business associations in Japan, estimated that deregulation would increase Japan’s real GDP by 177 trillion yen over the next ten years, creating 740,000 additional jobs. In addition, it would correct the price differential that existed between Japan and the international community, expand Japan’s range of products and

39 Ryutaro Hashimoto, ‘Challenges for the World Economy in Transitional Period and Development in the Asia-Pacific Region’, Vancouver, 2 May 1995.

40 Ryutaro Hashimoto, ‘Challenges for the World Economy in Transitional Period and Development in the Asia-Pacific Region’, Vancouver, 2 May 1995.

41 Ryutaro Hashimoto, ‘Challenges for the World Economy in Transitional Period and Development in the Asia-Pacific Region’, Vancouver, 2 May 1995.

42 Economic Measures toward steady economic recovery, 20 September 1995, Ministerial Conference for Economic Measures, Government of Japan.

43 Emergency Measures for Yen Appreciation and the Economy, Ministerial (Provisional Translation) Ministerial Conference on Economic Measures, 14 April 1995.

services, and raise the national standard of living. It would also increase international access to Japan's market, make the market more transparent and encourage new foreign investment.⁴⁴

The reform packages of 1996—economic, financial and fiscal

3.35 The emergency package was also designed to overcome pressing problems, such as the decline in asset prices by promoting efficient land use and revitalising the security market. The government was looking to financial institutions to dispose swiftly of their non-performing assets and was seeking to strengthen discipline in the management of such institutions and to formulate highly transparent financial markets. Finally, the government recognised the need to address the issue of mounting unemployment, which had climbed over the 3% mark, and the difficulties facing smaller enterprises.⁴⁵

3.36 In the face of continuing economic stagnation and the growing realisation that Japan needed to change to meet the challenges of the time, reform remained firmly on the political agenda. Organisations such as Keidanren announced their intention to 'keep a close watch on how the government proceeds, to what extent the 1,091 items targeted in the Plan are deregulated, and to ensure that the Plan is implemented'.⁴⁶

3.37 On 11 January 1996, Mr Ryutaro Hashimoto, a strong advocate of reform, became Prime Minister and, building on initiatives already in place, gave the reform process a firm nudge forward. During the year, he unveiled his plan to implement and promote six reform packages with the purpose of 'creating an overall economic and social system, which can stay in the forefront of global trends'. Three fundamental principles underpinned the reforms—capacity to respond to crises; freedom of choice; and co-existence which would encourage local communities to work together constructively and for the nation to move forward as a whole and in harmony with the international community. The six packages were to cover:

- administrative reform
- fiscal structural reform
- social security structural reform
- structural reform for the Japanese economy
- financial system reform

44 Address of Shoichiro Toyoda, Chairman of Keidanren, before the 57th Keidanren General Assembly, 26 May 1995.

45 'Economic Measures: toward steady economic recovery', Ministerial Conference for Economic Measures, Government of Japan, 20 September 1995.

46 Address of Shoichiro Toyoda, Chairman of Keidanren, before the 57th Keidanren General Assembly, 26 May 1995. For information on Keidanren, see Hidetaka Yoshimatsu, 'Japan's Keidanren and Political Influence on Market Liberalization', *Asian Survey*, vol. XXXVIII, no. 3, March 1998. He describes Keidanren as 'the principal power center of business'.

- educational reform.⁴⁷

3.38 The government accepted that the six packages were closely ‘interrelated and intertwined’. But clearly, at the forefront of its mind was the need to find solutions to the economic and financial difficulties plaguing the nation. In particular, it saw the urgent need to promote the rejuvenation of Japan’s economic structure as part of the six-area reform program. Three of the six packages had a direct bearing on the economy—economic, financial and fiscal structural reform.

Economic structural reform

3.39 As noted earlier, economic reform had long been a matter for debate in Japan and the announcement of the government’s reform packages in 1996 marked yet another development in this long process. The Deregulation Program adopted in 1995 was revised and approved by Cabinet in March 1996 and now covered 1,797 items.⁴⁸ At its very core, the reform program recognised that many of the systems and practices that had functioned well up to the present in Japan were now stifling the future development of the economy. The reforms were primarily designed to eliminate the high-cost structure in Japan and thereby create an environment that would encourage new business ventures to attract Japanese as well as foreign companies.⁴⁹

3.40 In Japan, a two-tiered economic system, known as a dual economic structure, had developed over the years. It comprised a highly productive, hypercompetitive, world renowned, cutting edge manufacturing export sector and a highly protected, non-competitive, inefficient domestic sector with costs higher than comparable industries throughout the world.⁵⁰ Companies such as Sony, Toyota and Toshiba are among the world’s most successful exporters and form part of the highly competitive sector of this dual structure. On the other hand, electricity suppliers, the transport industry and a plethora of small, often family-owned, businesses, belong to the rest, ‘the rump of the Japanese economy’, which is a drain on the national economy. Mr Peter Hartcher described this dual economic system as:

...a remittance economy where the profits and growth prospects generated overseas by the successful sector of the economy are then transferred or expropriated back home through taxes, through jobs, and through economic growth, to the rump...sector of the economy.⁵¹

47 Reforms and the Creation of a New Era Society—the six reform packages of the Hashimoto Administration, The Ministry of Foreign Affairs.

48 APEC, Deregulation Report 1997: Japan, <http://apecsec.org.sg/deregulation/jap.html> (20 October 1999).

49 See for example Shinji Sato, English translation of Minister Sato’s Speech at the Foreign correspondents’ Club of Japan, 16 June 1997, <http://www.miti.go.jp/press-e/f300001e.html> (10 November 1999).

50 Peter Hartcher, *Committee Hansard*, 15 April 1999, p. 325. See also, The Department of the Treasury, submission no. 63, p. 4; *The Economist Intelligence Unit’s Country Analysis, Japan, 2000*, p. 23.

51 Peter Hartcher, *Committee Hansard*, 15 April 1999, p. 325.

3.41 This protected sector for example resulted in extremely high electricity costs in Japan and transport costs five times those in the US.⁵² In underlining the burden that these domestic distribution and energy costs place on producers, Professor Kosai Yutaka cited domestic marine freight charges, which he wrote:

...are so high that the cost of transporting goods between Yokohama and Kobe is almost the same as that between Japan and Europe. Thus, even the production of quality products that have price competitiveness on shipment from the factory does not pay off if transportation costs are added...⁵³

3.42 Indeed, Mr Ian McLean, a witness before the Committee, explained that his business spent \$6,000 to move a display home from Australia to Japan but a further \$24,000 to get it from the wharf in Tokyo to a site 24 kilometres away.⁵⁴

3.43 Clearly, the protected home industries, which enjoy a huge array of rules and policies that shelter them from competition, are holding back economic progress. Regulations block the system with inefficient practices, drive up business costs, undermine the competitiveness of the export industries and inhibit the formation of internationally competitive industries in significant sectors of the economy.⁵⁵ Sectors whose competitiveness was suffering were pushing hard for change.

3.44 In December 1996 with a growing sense of urgency and in an attempt to accelerate the restructuring process, the Japanese Government agreed upon a 'Program for Economic Structure Reform'. This program was to facilitate the implementation of the measures set forth in the Deregulation Program. Although a number of commentators acknowledged that some significant improvements had resulted, they described Japanese deregulatory plans as 'quite modest'.⁵⁶

3.45 Mr Hashimoto's economic reform program continued to undergo review. At the end of March 1997, the Japanese Government announced its final revisions to its three-year Action Plan.⁵⁷ In May 1997, the specific details of the program were approved by cabinet as the 'Action Plan for Economic Structure Reform'.⁵⁸

52 BT Funds Management, 'Cherry Picking in Japan', 1999.

53 Kosai Yutaka, 'Economic Reform', in *Journal of Japanese Trade Industry*, No. 3, 1998, p. 10.

54 Ian McLean, Australia Japan Housing Ltd, *Committee Hansard*, 15 April 1999, p. 365.

55 Michael E. Porter and Hiroataka Takeuchi, 'Fixing What Really Ails Japan', *Foreign Affairs*, vol. 78, no. 3, May/June 1999, p. 78.

56 Stuart M. Chemtob, Special Counsel for International Antitrust Division, US Department of Justice, Keynote Address 'The Frustration and Promise of Japanese Deregulation', 4 April 1997, in Japan Information Access Project.

57 Press Conference by Prime Minister Ryutaro Hashimoto following the passage of the FY1997 Budget, 31 March 1997.

58 *News from MITI*, 'Structural Reform of the Japanese Economy', November 1997, <http://www.jef.or.jp/news/97nov.html> (19 October 1998).

3.46 The Action Plan had three broad goals—

To create an environment that would encourage new business activities: the plan called for solutions to problems associated with factors such as:

- funding—to ensure the smooth supply of funds to new business activities;
- human resources—to facilitate the shift of human resources to new and fast-growing business fields and supply human resources with creativity and the spirit of challenge;
- R&D, especially in the area of technology, to strengthen such research as an important basis for new business activities and protection of intellectual property;
- promotion of advanced information and telecommunications systems.

It also sought to foster an internationally attractive business environment through:

- drastic deregulation, notably the enforcement of sweeping deregulation to correct Japan's high-cost structure;
- improved domestic distribution—the cost of which in Japan, as shown earlier, was extremely high;
- the efficient production, distribution and use of energy;
- the establishment of conditions under which information and telecommunications industries could grow and compete internationally;
- the reform of systems concerned with corporate organization and labour;
- restructuring the corporate tax system to make it more attractive for business.

Finally, it sought to lighten the public burden on taxpayers and businesses from the viewpoint of maintaining economic vitality.⁵⁹

3.47 The reform program remained a central plank in the government's efforts to improve economic performance and was to undergo continued review and refinement.⁶⁰ Aside from the general objective of removing unnecessary regulations, the reform process was particularly intended to encourage new enterprises, develop human resources and promote and advance technology.⁶¹

59 The Action Plan for Economic Structure Reform, May 1997; *News from MITI*, November 1997.

60 For example see Takafusa Shioya, 'Japanese Economic Issues', Mr Takafusa Shioya, Director-General of the Coordination Bureau, Economic Planning Agency, 24 November 1997. Ministry of Foreign Affairs. See also General Affairs Division, Industrial Policy Bureau, Ministry of International Trade and Industry, 'An Outline of Economic Structure Reform', *Journal of Japanese Trade & Industry*, no. 3, 1998.

61 General Affairs Division, Industrial Policy Bureau, Ministry of International Trade and Industry, 'An Outline of Economic Structure Reform', *Journal of Japanese Trade & Industry*, no. 3, 1998.

Financial reform—Big Bang

3.48 Financial reform, one of the areas identified under the six reform packages, demanded most urgent attention. Until the late 1970s, Japan operated with highly regulated financial markets.⁶² This system appeared to have performed well. Households placed their savings in bank deposits or postal savings accounts and the funds were channelled to selected industries at cheap interest rates. The economy certainly flourished under this system suggesting that funds were being effectively funnelled into profitable and productive areas; that bad loans were manageable and financial institutions successful.

3.49 But from the 1970s Japan, now a fully mature industrialised economy, saw its economic growth rate slow at a time when there was a gradual, though ad hoc, relaxation of some regulations including a slow ‘decontrol of interest rates’. The deregulation process, however, took place without the establishment of an overarching effective system of prudential regulation and supervision.

3.50 Private savings began to outstrip the demand for private investment. With a slowing in economic growth and a subsequent lower demand for loans to finance plant and equipment investments by the large manufacturers, lending institutions moved into real estate financing which, as noted earlier, fed the boom economy of the late 1980s. With the collapse of the bubble economy, the faults and failings of the financial system, aggravated by the burgeoning bad debt problem, became increasingly apparent and some officials began to agitate for drastic reform.⁶³

3.51 In November 1996, Prime Minister Hashimoto announced a bold set of plans to overhaul Japan’s financial system—the ‘Big Bang’ plan.⁶⁴ Japan’s financial institutions had remained relatively domestic in focus and had not kept pace with changes in the international financial world.⁶⁵ Moreover, the anti-competition principle that characterised the catch-up model of Japan’s postwar economic system was clearly at work in the financial sector. The ‘convoy system’ of financial regulation, which required all institutions ‘to move in the same direction at the same pace’, while protecting weak institutions from failure allowed the system to fall behind international standards.⁶⁶

62 Edward J. Lincoln, ‘Evaluating Japan’s “Big Bang” Financial Deregulation’, Prepared for the Trilateral Forum on US-Japan-China Cooperation in the Asia Pacific Region, Berkeley, 11–12 November 1997.

63 See Edward J. Lincoln, ‘Evaluating Japan’s “Big Bang” Financial Deregulation’, Prepared for the Trilateral Forum on US-Japan-China Cooperation in the Asia Pacific Region, Berkeley, 11–12 November 1997.

64 Structural Reform of the Japanese Financial Market—Toward the Revival of the Tokyo Market by the Year 2001, <http://www.mof.go.jp/english/big-bang/ebb6.htm> (26 April 2000).

65 See Professor Tessa Morris-Suzuki, submission no. 3; p. 13; Bradley Treadwell, Osborne Associates, submission no. 8, p. 3.

66 Noguchi Yukio, ‘The Persistence of the 1940 Setup’, *Japan Echo*, vol 24, Special issue, 1997; Taichi Sakaiya, Minister of State, Economic Planning Agency, Government of Japan, ‘The Present and Future

3.52 The principal object of Hashimoto's ambitious initiative was to transform Tokyo into a world class financial market to rival, even surpass, London and New York. More specifically, the Big Bang reforms were to find a more efficient way to manage and invest private assets, involving as much as ¥1,200 trillion of individual savings, and to provide funds for the development of industries that would 'carry the coming era on their shoulders'. Put simply, the Big Bang was to open up the Japanese financial sector to international competition—to create a system where the market mechanism functioned to its full extent and where optimal allocation of resources would be achieved.⁶⁷

3.53 Reform was to be based on the clearly defined principles of:

- Freedom—to establish a free market where the market mechanism prevails;
- Fairness—to create a transparent, reliable and credible market by clarifying and enhancing transparency of rules and protecting investors' interests; and
- Globalization—to work toward an international market ahead of its time by establishing a legal system, accounting system, and supervisory regime consistent with international standards.⁶⁸

3.54 The Japanese Big Bang that Prime Minister Hashimoto had been calling for since late 1996 aimed at making up for lost time with a sweeping package of reforms covering not just the securities business but also various other aspects of the financial system, including specifically:

- the elimination of the barriers separating the banking, securities, and insurance industries;
- the lifting of the postwar ban on financial and other holding companies;
- the deregulation of insurance premiums;
- the liberalisation of foreign exchange;
- the reform of the corporate accounting system, with a shift from valuation of assets at acquisition cost to valuation at current market prices;
- a review of the financial regulatory system and, in particular, the strengthening of the supervision of financial institutions; and

of the Japanese Economy', Speech at Yale University, Connecticut, May 2000, <http://www.epa.go.jp/2000/b/0505b-daijinkouen-e.html> (5 July 2000).

67 About the financial system reform, (The Japanese version of the Big Bang), <http://www.mof.go.jp/english/big-bang/ebb1.htm>. See also Professor Tessa Morris-Suzuki, submission no. 3.

68 Directions issued by Prime Minister Hashimoto, 11 November 1996 and Financial System Reform—Toward the early achievement of Reform, 13 June 1997, <http://www.mof.go.jp/english/big-bang/ebb32.htm>. See also Queensland Government, submission no. 18, p. 7; NSW Government, submission no. 25, p. 8.

- a revision of the Bank of Japan Law to give the central bank greater autonomy and to secure transparency in the financial policy making.⁶⁹

3.55 The reform package was hailed as ‘the most ambitious and far reaching set of financial reforms ever undertaken in Japan—truly a Big Bang’. Prime Minister Hashimoto directed that the package be implemented by 2001.⁷⁰

3.56 The reforms also recognised the pressing need to dispose of the bad debts accumulated by the banking institutions. The government had already taken steps to solve the problem of the *jusen* companies. These companies were established in the mid-1970s as subsidiaries of banks, securities firms and life insurance companies. The *jusen* companies were not permitted to accept deposits and borrowed from other institutions, including banks and agricultural credit cooperatives, to provide loans. During the 1980s they turned aggressively to real estate lending. With the collapse of the property market, the *jusen* companies were saddled with massive amounts of non-performing loans. In 1995, the extent of their problem became public with a Ministry of Finance report estimating that their non-performing loans amounted to 9.6 trillion yen. The government stepped in to assist in the liquidation of the *jusen* which were dissolved in 1996. The banks were required to contribute significantly to the bail out. This measure did not, however, address the problem of the banks’ bad debts.⁷¹

3.57 The government remained sensitive to the pressure for continuing economic and financial reform and frequently referred to its commitment to such action.⁷² In June 1997, it brought forward its broad ranging plan for financial system reform.⁷³ The measures included abolishing operational regulations to ordinary banks in the short and long-term finance system, diversifying the business operations of securities companies, liberalising brokerage commissions for stock trading; liberalising the foreign exchange business and cross-border capital transactions; establishing accounting standards, including the use of market-to-market method for such financial instruments as securities and derivatives; and improving the practice and system of auditing to make them comparable to the international norm.⁷⁴

69 *Japan Echo*, vol. 24, no. 3, August 1997; Administrative Reform Program, (Outline), Cabinet decision, 25 December 1996.

70 *Japan Echo*, vol. 24, no. 3, August 1997.

71 Takatoshi Ito, ‘Japan’s Financial Crisis: Resemblances with East Asia’, *Pacific Economic Papers no. 288, Japan’s Financial Reform*, Australia-Japan Research Centre, February 1999, p. 2.8. See also Gavan McCormack, ‘Is Japan Facing Financial Armageddon?’, *New Asia Pacific Review*, vol. 3, no. 2, 1997, pp. 11–12; Professor Hiroya Ichikawa, ‘A Road for the Economic Recovery of Japan: a Search for a New Paradigm’, *Japan Reports*, Consulate-General of Japan, Sydney, May 1999.

72 See for example Economic Outlook and Basic Stance on Economic Management for FY 1997, approved by the cabinet on December 19, 1996.

73 Ministry of Finance, ‘Financial System Reform’, 13 June 1997, <http://www.mofa.go.jp/english/big-babg/ebb32.htm> (6 April 1999).

74 Ministry of Finance, ‘Financial System Reform’, 13 June 1997, <http://www.mof.go.jp/english/big-babg/ebb32.htm> (6 April 1999).

Fiscal structural reform—1997 the year of fiscal reform

3.58 The Japanese economy seemed to respond positively to the stimulus package of April 1995 and the on-going program of reforms. It showed signs of recovery with a return to positive growth and a spurt in economic activity.⁷⁵ In 1996, Japan registered a real GDP growth rate of 3.6%.⁷⁶ By the close of the year, the economic outlook was brighter. According to the Economic Planning Agency:

Although the pace of recovery is gradual, demand in the private sectors is gathering the strength of steadiness. Thus, the basis for an autonomous economic recovery centred on private demand is being established.

It acknowledged that the unemployment situation, which had reached 3.4 per cent, was still serious despite continued improvement in the economy. Nonetheless, it asserted confidently that in FY1997 ‘an autonomous economic recovery led by increasingly firm private demand will be realised’.⁷⁷

3.59 Taking heart from the boost in economic growth, Japanese authorities turned their attention to reducing the budget deficit in earnest. Although the various stimulus packages introduced during the early 1990s had sustained moderate economic growth, they had also eaten into public finances. Japan’s fiscal standing had deteriorated sharply over recent years, with fiscal deficits surging from 2.0 per cent of GDP in 1992 to 7.3 per cent of GDP in 1996.⁷⁸ According to the WTO, in 1995 the overall fiscal deficit of central and local government rose to over 5 per cent and gross government debt to over 100 per cent of GDP.⁷⁹ Some commentators had no hesitation in declaring that the ‘deterioration of the national budget had reached crisis proportions’. With increasing alarm, they could see Japan’s national debt overtaking the country’s GDP.⁸⁰

3.60 Officials and the Prime Minister himself were worried that government debt would seriously undermine the long-term prospects of the Japanese economy. In January 1997, he designated the coming fiscal year: ‘the first year of fiscal structural reform...the first year in which we take our first step toward rebuilding our fiscal

75 Professor Craig Freedman, *Committee Hansard*, 15 April 1999, p. 342.

76 MITI, ‘The Economic Stimulus Package of Japan’, 15 April 1998.

77 Economic Outlook and Basic Stance on Economic Management for FY 1997, approved by the cabinet on December 19, 1996, http://www1.meshnet.or.jp/aep_home/English/outlook97.html (2 June 1999).

78 Queensland Government, submission no. 18, p. 7.

79 WTO Trade Policy Review of Japan, (1998), 20 November 1998.

80 Yasuo Kanzaki, ‘Deregulation in Japan: Big Bang or Big whimper?’, a talk delivered 7 March 1997: Katsuhiko Eguchi, Executive Vice President, PHP Research Institute Inc; Harano Joji, ‘The Hashimoto Reform Program’, *Japan Echo*, June 1997. See also, Nomura Research Institute, *Quarterly Economic Report*, vol. 27, no. 2, May 1997, p. 1.

system'. He announced the government's decision to raise the consumption tax, introduce local consumption tax and discontinue special tax cuts.⁸¹

3.61 On 18 March 1997, in explaining further his policy to contain the mounting fiscal deficit, the Prime Minister announced that the following five principles would underpin fiscal reform:

- The year 2003, rather than 2005, to stand as the interim target date for fiscal structural reform under which the deficit is not to exceed 3% of GDP.
- The three remaining years of the decade to be a period of concentrated reform—spending patterns in several categories to change without reserving any 'sacred cows' and specific quantitative targets for reduced spending to be set.
- General expenditure in the FY1998 budget to be set lower than the FY1997 budget.
- Significant reductions to be introduced for long term plans being pursued by the National Government.
- The burden borne by taxpayers, made up of taxes, social insurance premiums and the fiscal deficit, to be kept below 50% of the national income total.⁸²

3.62 In outlining his budget for 1997/98, Prime Minister Hashimoto drew attention to the massive public debt that Japan had accumulated which amounted to 254 trillion yen outstanding in national bonds alone. At the very centre of his concern was the rapidly ageing population and the higher expenditure for social welfare programs it would demand. He stated, 'As our society ages and birth rates fall, our children and grandchildren will be saddled with a tremendous burden unless we take vigorous steps now to achieve fiscal structural reform'. He expressed an urgent concern for Japan's future noting in particular that:

Every year the number of people eligible to receive pension benefits increases by almost one million. And as everyone is well aware, medical expenses are rapidly rising at the same time. If the system is not changed in some way, social security related expenditures will grow by close to one trillion yen annually. Under these circumstances, all obstacles must be overcome during FY1998 to ensure that we achieve a reduction in ordinary expenditures.⁸³

81 Policy Speech by Prime Minister Ryutaro Hashimoto opening the 140th session of the Diet, 20 January 1997.

82 Press Conference by Prime Minister Ryutaro Hashimoto following the Passage of the FY 1997 Budget, 31 March 1997.

83 Press Conference by Prime Minister Ryutaro Hashimoto following the passage of the FY1997 budget, 31 March 1997.

Prime Minister Hashimoto expected resistance to change but declared his strong determination to see necessary reform implemented.⁸⁴

3.63 In June 1997, he again highlighted the problem of ballooning debt and of his government's policy of fiscal contraction. He announced that at the end of FY1997, total long-term debt would reach 476 trillion yen, threatening to close in on the gross domestic product of 515 trillion yen. In citing these bald figures, he argued that, 'the deficit structure must be changed thoroughly through a comprehensive review of all expenditures without allowing for any sacred areas'.⁸⁵

3.64 In attempting to balance the economic scales by protecting and consolidating public revenue, however, there was the danger that savings in public sector spending would widen the supply-demand gap. A tightening of the public purse would further weaken domestic demand, depress prices, erode tax revenues, and overall dampen economic activity. Nevertheless, the government for the time being remained committed to keeping a tight reign on the budget deficit.

3.65 The economy, however, was deteriorating at a rate that defeated the government's attempts to maintain positive growth. The government expected the economy to slow down in the first half of FY1997 due to factors such as the increased consumption tax, which was raised from 3 to 5 per cent, but anticipated that when coupled with structural reform measures including deregulation, the economy, led by private demand, would gradually recover.⁸⁶

3.66 As expected, this fiscal policy did indeed register in the second quarter of 1997 with a fall in consumer spending. There was a slight recovery in the third quarter but, with the economic crisis deepening and spreading in Asia and consumer confidence at home fading fast, private consumption expenditure fell markedly, the economy spluttered, stalled and then began to slip backward. Japan's economy contracted at a seasonally adjusted rate of 0.4% in the December quarter.⁸⁷

1997—The Japanese economy heads for recession

3.67 The Japanese people were alerted to the seriousness of the situation in November 1997. This most troubled month saw a number of well-known and established financial institutions fail in quick succession laying bare the precarious state of Japan's financial system. On 3 November, the Sanyo Securities Company,

84 Press Conference by Prime Minister Ryutaro Hashimoto following the passage of the FY1997 budget, 31 March 1997.

85 Press conference by Prime Minister Ryutaro Hashimoto on the Final Report of the Conference on Fiscal Structural Reform, 3 June 1997; Cabinet decision, 3 June 1997, <http://www.kantei.go.jp/foreign/0624reform.html> (27 May 1999).

86 Economic Outlook and Basic Stance on Economic Management for FY 1997, approved by the cabinet on December 19, 1996.

87 Australian Bureau of Agricultural and Resources Economics (ABARE), submission no. 21, p. 7. See also Nomura Research Institute, *Quarterly Economic Review*, vol 27, no. 3, August 1997, p. 1.

Ltd, after failing in its endeavours to rehabilitate its affiliate non-banks which had accumulated significant amounts of bad debts, reported that it would be suspending part of its business. On 17 November, the Hokkaido Takushoku Bank, Limited, one of the nation's largest banks, reported to the Ministry of Finance the difficulties it was having in continuing business on a normal basis and informed the Ministry of its intention to transfer its business to a transferee bank. A week later, Yamaichi Securities Co., a prestigious company that had once reigned at the top of Japan's securities industry, announced, after being declared bankrupt by the Tokyo District Court, that it would close its doors and surrender its securities business licence. Finally, two days later, on 26 November, the Tokuyo City Bank announced that in the face of serious liquidity problems it had agreed to transfer the bank's business to a transferee bank.⁸⁸

3.68 The Hashimoto Cabinet feared that the collapse in the credibility of Japan's financial system might cause a panic with global repercussions.⁸⁹ On 26 November, the Minister of Finance and the Governor of the Bank of Japan issued a joint statement reaffirming their resolve 'to ensure the stability of interbank transactions as well as to fully protect deposits'. They stated:

...we are determined to provide liquidity in a sufficient and decisive manner in order to prevent any delay in payments of deposits and other liabilities of financial institutions. We strongly request people not to be misguided by groundless rumors and to act sensibly.⁹⁰

3.69 Alarmed by the failure of these firms and the serious erosion of confidence in the Japanese economy, the government announced in December 1997 and the following January measures to stabilise the financial system and to restore faith in the Japanese economy.⁹¹

Rescue package—December 1997

3.70 To rescue the financial system, the government set aside 30 trillion yen of public funds; 13 trillion was to recapitalise the debt ridden banking industry and 17 trillion to protect depositors, until 2001, in failing institutions. In February 1998,

88 Statement by the Minister of Finance, 3 November 1997; Statement by Minister of Finance, tentative translation, 17 November 1997; Statement by the Government Concerning the Yamaichi Securities Co, 2 June 1999, Bank of Japan; <http://www.boj.or.jp/en/press/danwa003.htm> (24 January 2000); Statement by Minister of Finance on the Tokuyo City Bank, tentative translation, 26 November 1997. See also Taichi Sakaiya, Minister of State, Economic Planning Agency, Government of Japan, 'The Present and Future of the Japanese Economy', Speech at Yale University, Connecticut, May 2000, <http://www.epa.go.jp/2000/b/0505-daijinkouen-e.html> (5 July 2000). The term 'transferee bank' is taken from the official statement issued by the Minister of Finance.

89 Dr Tasuo Takao, submission no. 28, p. 6.

90 Joint Statement by the Minister of Finance and the Governor of the Bank of Japan, tentative translation, 26 November 1997, <http://www.mof.go.jp/english/daijin/ele012.htm> (30 March 1999).

91 Address by the Prime Minister Ryutaro Hashimoto on Measures to Stabilise the Financial System and Economic Management to the 142nd session of the National Diet.

the government enacted its 30 trillion financial stabilization package which finally secured a credible safety net for depositors.

3.71 Moreover, the government, all too aware of the importance to guarantee the soundness of financial institutions and similar agencies by promoting the speedy disposal of the non-performing assets, announced it would introduce the system of Prompt Corrective Action.⁹² Under this system, banks would be required to conduct periodic self-assessment of capital, based on objective criteria and subject to external audit. When a bank's capital ratio fell below a certain benchmark, the newly established Financial Supervisory Agency would step in to put in place measures to minimise any further risks.⁹³ Mr Hashimoto stated that the government would introduce such action to ensure transparent and fair financial administration and to maintain the smooth supply of capital. It would also make 25 trillion yen available, including credit guarantees, by establishing new lending programs run by government financial institutions.⁹⁴

Bad loans

3.72 By this time, people from both the public and private sectors, and from the media and academia, recognised that one of the major challenges confronting the country was the 'bad loan' problem.⁹⁵ One commentator likened the Japanese financial institutions to invalids in wheelchairs pushed by the authorities and kept alive by artificial life support—notably, 'the massive infusions of cash from the state sector...'.⁹⁶

92 Financial System Reform—Toward the early achievement of Reform, 13 June 1997, <http://www.mof.go.jp/english/big-bang/ebb32.htm>.

93 Curtis J. Milhaupt, 'Japan's Experience with Deposit Insurance and Failing Banks: Implications for Financial Regulatory Design?', Institute for Monetary and Economic Studies, Bank of Japan, *IMES Discussion Paper Series 99-E-8*, March 1999, pp. 23–4. The prompt corrective action regime came into effect in April 1998. The Financial Supervisory Agency (FSA), an independent agency which reports directly to the Prime Minister, took over the job of monitoring and supervising the country's banks from MoF's bank bureau at the end of June 1998. See also Robin Radin, 'The Evolution of Japan's Economic and Regulatory System: A Brief History', The National Investment Company Service Association, <http://www.us-japan.org/JapanBoston/radin.htm> (19 October 1999); Thomas F. Cargill, 'Briefing Paper', 15 December 1997, <http://www.nmjc.org/JIAP/events/papers/carhdout.html> (19 October 1999).

94 Address by the Prime Minister Ryutaro Hashimoto on Measures to Stabilise the Financial System and Economic Management to the 142nd session of the National Diet.

95 See Paul Blustein, *Washington Post*, 4 April 1998, p. AO1. Also Mr Jiro Ushio stressed that one of the most pressing issues was the need to deal with the bad debt that 'has hobbled financial revitalization', Jiro Ushio, Chairman's Address for the 1998 Annual Meeting, Keizai Doyukai, 22 April 1998; see evidence by Professor David Allen, *Committee Hansard*, 25 February 1999, p. 188.

96 Interview with Kenneth S. Courtis, 'Japan's Big Bang and the Asia Meltdown', NIRA Review, Spring, 1998). See also Brian Robins, 'Japan Shock Absorbers Lose Their Resilience', *Business Review Weekly*, 19 October 1998; Shigemitsu Sugisaki, 'The Outlook for Japan and its Global Implications', Address by Shigemitsu Sugisaki, Deputy Managing Director of the International Monetary Fund, the Kobe University/IMF Symposium, Kobe, Japan, 14 July 1998; David D. Hale, Global Chief Economist, Zurich Insurance Group, 'The Financial Crises in Japan and Asia: a Financial Insider's View', *JEI Report*, no. 36A, 25 September 1998, p. 3.

3.73 Moreover, there was a growing sense that the full extent of the debt problem was yet to be fully revealed. The IMF noted in October 1998:

A distinctive aspect of the banking crisis in Japan has been that opaque accounting practices have masked the true size of problem loans for many years, and official statements regarding problem loans have lacked credibility in markets...The lack of transparency in even recognizing the scale of the problems in the banking sector has undermined confidence among businesses and the public at large, with deleterious effects on domestic demand...⁹⁷

The message was clear—more radical steps needed to be taken; bad debts must be removed from balance sheets.

Public confidence collapse

3.74 The mood of uncertainty and distrust gathering around the bad debt situation served to erode further public trust in Japanese business and in Japan's economy as a whole.⁹⁸ Some analysts considered that the basic health of the economy rested on whether the government and the monetary authorities could 'revive the credit-creating mechanism—the engine of economic growth—by restoring confidence in the financial system'.⁹⁹ At the very core of this problem was the delay in finalising the bank recapitalisation scheme.

3.75 The government had clearly underestimated the damage that their austerity budget would inflict on the economy. The IMF concluded:

In hindsight, the large-scale tightening of Japanese fiscal policy in 1996–97 was clearly excessively ambitious... At the time key policy decisions were made, Japan had experienced only about a year of solid recovery after four years of near stagnation. With that year of recovery boosted by substantial fiscal stimulus, there was reason to question whether economic expansion had yet been put on a strong, self-sustaining basis, capable of withstanding a large sudden withdrawal of fiscal support.¹⁰⁰

97 IMF, *World Economic Outlook*, October 1998, Chapter IV; Japan's Economic Crisis and Policy Options', IMF, 1998, p. 120. See also Tadashi Nakamae, 'Japan's Impending Financial Crisis will Expedite the Necessary Shift of Resources from the Old to the New Economy', Presentation for the OECD Business and Industry Policy Forum on Realising the Potential of the Service Economy: Facilitating Growth, Innovation and Competition, Paris, 28 September 1999. Joe Peek and Eric S. Rosengren, 'Determinants of the Japan Premium: Actions Speak Louder than Words', p. 13.

98 For example Mr Jiro Ushio, chairman of Keizai Doyukai noted, 'The most important issue currently confronting executives and the companies we run is the redemption of public trust'. Jiro Ushio, Chairman's Address for the 1998 Annual Meeting, Keizai Doyukai, 22 April 1998.

99 Nomura Research Institute, *Quarterly Economic Review*, vol. 27, no. 4, November 1997, p. 1.

100 *IMF World Economic Outlook*, October 1998, Chapter IV 'Japan's Economic Crisis and Policy Options', IMF, 1998, p. 116.

3.76 Mr Richard C. Koo drew the analogy: ‘If you put a person who can hardly stand on their own feet on a diet, that could be fatal. And I’m afraid that’s what the Japanese Government ended up doing...’¹⁰¹ He argued that the expansionary fiscal policy had kept the economy going while Japanese banks, corporations and individuals were trying to correct their balance sheets. According to Mr Koo, ‘As long as there’s income flow, Japanese will pay back their loans’.¹⁰² In summary the government’s contractionary budget dampened aggregate demand and in effect crippled the economy.

3.77 Japan’s respective annual growth rates had been 3.0% in JFY 1991 followed by 0.4% in 1992, 0.5% in 1993, 0.7% in 1994, 2.7% in 1995 and finally 3.4% in JFY 1996. The economy grew by only 0.9% in real terms in Calendar year 1997, the fourth lowest rate of growth recorded in Japan since 1956. The December 1997 quarter recorded—0.2% growth compared with the previous quarter, and a further contraction of 1.3% in the March quarter 1998 confirmed that Japan was in recession.¹⁰³

Rescue package—April 1998

3.78 With no signs of improvement in economic activity in 1998, analysts began to talk of the economy slipping from recession into depression. Mr Douglas Ostrom, senior economist with the Japan Economic Institute, concluded:

On the face of it, a long-term economic decline, coupled with a contractionary fiscal policy, weak export markets and bank failures leading to unusual difficulty in implementing monetary policy, make up a pretty potent and evil brew.¹⁰⁴

3.79 The government accepted that Japan’s economy was struggling to recover; that the series of failures of large financial institutions symbolised the parlous state of the country’s economy. As Japan entered its second quarter of 1998, government officials, against the backdrop of huge government debt, were confronted with the large domestic supply-demand gap, weak consumer spending, a struggling financial system buckling under a substantial debt burden, low productivity growth, rising unemployment and a rapidly ageing population.¹⁰⁵

101 Richard C. Koo, ‘Is Japan misunderstood?’, Nomura Research Institute at the Economic Strategy Institute, 13 July 1998.

102 Richard C. Koo, ‘Is Japan misunderstood?’, Nomura Research Institute at the Economic Strategy Institute, 13 July 1998.

103 ABARE, submission no. 21, p. 2; NSW Government, submission no. 25, p. 5.

104 Douglas Ostrom, ‘Limping Toward the Millennium: Japan’s Economy in the Late 1990s’, *JEI Report*, no. 14A, 10 April 1998, p. 6.

105 See New South Wales Government, submission 25, p. 5; and also Summary of Comprehensive Economic Measures, Economic Planning Agency, 24 April 1998; and Koji Omi, Speech, The Royal Institute of International Affairs, Chatham House, 29 April 1998, London, <http://www.epa.go.jp/98/b/19980429b-daijin-e.html> (7 June 1999).

3.80 To meet the growing economic crisis, the government put to one side its fiscal rectitude and once again resorted to a stimulation package to lift domestic demand.¹⁰⁶ On 9 April 1998, Prime Minister Hashimoto announced this new economic stimulus package worth around 16.7 trillion yen which included 10 trillion yen, or approx 2% of GDP, in actual fiscal spending by the central and local governments. At the time, this stimulus package was the largest in Japanese history.¹⁰⁷

3.81 Overall, the package was designed to enhance industry development and to provide some funds for infrastructure development. It was built around three main pillars—fiscal policy to boost domestic demand in the short term; economic structural reform to encourage growth in the longer term; and measures to resolve the bad loan problem which was weighing down economic recovery.¹⁰⁸

3.82 Of the 16 trillion yen, a total of around 7.7 trillion yen in projects was to be implemented by the central and local governments to expand domestic demand. It was to be allocated approximately as follows:

- 1.6 trillion yen in special projects for environment and new energy;
- 1 trillion yen in special projects for information and communications and science and technology;
- 1 trillion yen in special projects to improve social welfare, medical treatment and education;
- 800 billion yen in special projects for the efficient supply of diversified distribution services;
- 800 billion yen in emergent disaster prevention projects to protect national lands from disasters as well as people's lives and assets;
- 800 billion yen to special projects for inducing private investment through the redevelopment of downtown areas to maximise economic impact of public investment; and
- 200 billion yen in disaster reconstruction.

3.83 The central government requested local governments to increase their independent public works without financial support from the central government by 1.5 trillion yen to build up social infrastructure reflecting regional situations.¹⁰⁹

106 The Economic Intelligence Unit Ltd, *EIU Country Report*, 2nd Quarter, 1998, p. 19.

107 MITI, 'The Economic Stimulus Package of Japan', 15 April 1998. See also Queensland Government, submission no. 18, p. 6.

108 Speech by Minister Koji Omi at the Royal Institute of International Affairs, London, 29 April 1998, <http://www.epa.go.jp/98/b/19980429b-daijin-e.html> (7 June 1999).

109 Summary of Comprehensive Economic Measures, Economic Planning Agency, 24 April 1998.

3.84 The overall plan also included tax deductions amounting to over 4 trillion yen. On top of the 2 trillion yen reduction in individual income tax and individual inhabitants tax already in place, an additional 2 trillion tax reduction would be implemented within the calendar year while the 2 trillion temporary tax reduction would continue into the next year.¹¹⁰ The government hoped that the income tax reduction would raise consumption through increased disposable income, lift private demand and give the economy a necessary fillip.¹¹¹ Structural reform of the tax system was also envisaged.¹¹²

3.85 Even though the fiscal deficit of the central and local governments stood at 4.7% of GDP, and accumulated government debt had climbed to 103% of GDP in fiscal year 1998, the government decided that, while relaxing its policy, it would maintain its basic stance toward fiscal consolidation. It acknowledged that the necessity for fiscal structural reform had not changed and that fiscal restraint was critical for Japan's future with its ageing population. The Prime Minister, believed, however, that in light of the severe economic situation the government should 'urgently examine what measures should be taken as an emergency approach, while maintaining the basic structure of the fiscal structural reform'.¹¹³ The government announced that the Fiscal Structural Reform Act would be amended in order to provide flexibility so that it would be able to expand temporarily the fiscal deficit. In addition, the target year for reducing the fiscal deficit to 3% of GDP would be delayed from the year 2003 to 2005.¹¹⁴

3.86 Fiscal policy was only one prong of a multi-pronged approach to tackling the country's economic troubles. The government remained committed to implementing structural reform, with a special emphasis on the deregulation process to boost economic activity. In the financial sector, the long awaited 'Big Bang' program came into force as scheduled from April 1998.¹¹⁵

3.87 Some authorities expressed confidence that the measures in the April package would see the official projection of 1.9% real growth in fiscal year 1998 fully realised.¹¹⁶ Others, not so confident, suggested that the scale of tax cuts would not be

110 Statement by Prime Minister Hashimoto at the Press Conference on the Occasion of the Approval of the FY 1998 Budget, 9 April 1998, <http://www.kantei.go.jp/foreign/980424fypress.html> (10 October 1999); MITI, 'The Economic Stimulus Package of Japan, 15 April 1998.

111 Koji Omi, Speech, The Royal Institute of International Affairs, Chatham House, 29 April 1998, London, <http://www.epa.go.jp/98/b/19980429b-daijin-e.html>.

112 MITI, 'The Economic Stimulus Package of Japan', 15 April 1998.

113 Statement by Prime Minister Hashimoto at the Press Conference on the Occasion of the Approval of the FY 1998 Budget, 9 April 1998, <http://www.kantei.go.jp/foreign/980424fypress.html> (10 October 1999).

114 Speech by Minister Koji Omi at the Royal Institute of International Affairs, London, 29 April 1998, <http://www.epa.go.jp/98/b/19980429b-daijin-e.html> (7 June 1999) and MITI, 'The Economic Stimulus Package of Japan, 15 April 1998.

115 MITI, 'The Economic Stimulus Package of Japan', 15 April 1998.

116 Koji Omi, Speech, The Royal Institute of International Affairs, Chatham House, 29 April 1998, London, <http://www.epa.go.jp/98/b/19980429b-daijin-e.html> (7 June 1999).

enough to ‘bring shoppers back into the streets’ and generally ‘there remains a strong chance that this latest stimulus package will be insufficient and that more public money will be necessary’.¹¹⁷ On the other hand, Minister Koji Omi stated:

In the long run, such fiscal stimulus effects combined with positive impacts of the other structural measures in the package will surely contribute to economic recovery. This will lead to fully developing the potential of the private sector, expanding domestic demand, and putting the Japanese economy back on a sustainable growth path.¹¹⁸

3.88 In June 1998, the government put in place legislation intended to reform the financial system. Under this legislation individual components of the reform would be introduced rapidly and successively toward 2001, including ‘the introduction of new securities investment trust schemes, the replacement of the licensing system with a registration system for securities companies, full liberalization of brokerage commissions, the promotion of cross-sectorial entry in the financial fields, strengthening the function of the OTC markets, and enhancement of fair trading rules’.¹¹⁹

3.89 But the economy failed to respond—the pump-priming measures did not inspire market sentiment; the bad debts remained a nasty blot on the nation’s balance sheets and consumer confidence, already depressed, waned further. The Japanese economy continued to languish and unemployment which had risen from an average of 2.5% in the 80s to 3.1% in 1995 and, while still low by world standards, climbed to 4.1% in August 1998.¹²⁰

3.90 According to one journalist, ‘the government has followed the pattern of its predecessors by announcing one package after another of public works projects, but these have proved insufficient at lifting the economy out of the doldrums, and promises of new packages are starting to ring hollow to jaded investors’.¹²¹

3.91 Criticism was being levelled at the government for doing ‘too little, too late’. The structural reform programs instituted by the government were making slow progress and events seemed to derail attempts by government to haul the economy back on track. For many Japanese, the attempts to reform had ‘generated considerable impatience both in Japan and abroad in the course of repeated cycles of anticipation, disappointment, and revisions accompanied by continued stagnation’. The call became louder and more persistent for government to make an unequivocal commitment to

117 The Economic Intelligence Unit Ltd, *EIU Country Report*, 2nd Quarter, 1998, p. 20.

118 Koji Omi, Speech, The Royal Institute of International Affairs, Chatham House, 29 April 1998, London, <http://www.epa.go.jp/98/b/19980429b-daijin-e.html> (7 June 1999).

119 The Minister of Finance, statement on bills concerning financial system reform, 5 June 1998.

120 ‘The Challenge of Structural Reform and Pursuing Dynamism in Society and Economy’, Joint Report by the Social and Economic Outlook Committee and the Economic Entity Role Committee, June 1998, <http://www.epa.go.jp/98/e/19980622e-keishingoudou-all-e.html>.

121 Paul Blustein, *Washington Post*, 4 April 1998, p. AO1.

reform and to put in place definite, concrete and effective measures to deal with the bad debt problem.¹²²

3.92 Unfortunately for Prime Minister Hashimoto, his reform agenda, while forward looking, did come too late. By the beginning of 1998, the outlook for the Japanese economy was bleak. The failure of successive LDP governments to undertake substantial structural reform had resulted in weak economic growth. In addition, the policy of fiscal restraint was ill-conceived. At a time of feeble economic growth, compounded by the effects of the Asian economic crisis, expansionary rather than contractionary measures seemed in order.

3.93 On 18 June, at the closing of the parliamentary session, the Prime Minister conceded that there was an 'excessive loss of self-confidence in Japan'. He acknowledged that his country faced a very severe situation 'marked by a weakening yen, sluggish stock prices and rising unemployment'. Nonetheless, he believed that 'the prompt and steady implementation of the annual and supplementary budgets, combined with the implementation of measures to resolve the issue of non-performing loans' would enable Japan to 'tap its potential strengths fully and restore vigorous economic growth pulled by the people and private enterprise'.¹²³

3.94 But the apprehensions of the Japanese people could not be assuaged. Rumours about banks and banks' stocks being sold excessively prompted the Minister of Finance, on 19 June, to restate his commitment to ensure the stability of interbank transactions and to fully protect deposits. He drew attention to the new Financial Supervisory Agency, which was to come into operation within days and the two Financial Stabilization Acts which were to strengthen Japan's legislative framework in support of the government's commitment to stabilise the financial system.¹²⁴

3.95 The people, however, remained unconvinced. Despite the new stimulus package, the implementation of reform measures and the attempts to stabilise the financial system, public confidence in the Japanese economy, especially the financial system, remained weak.

1998—The Obuchi Cabinet for 'Economic Revival'

3.96 The Japanese people registered their disapproval of, and frustration with, a government seemingly unable to revive their failing economy and to restore their faith in the future. On 13 July, following the humiliating defeat of the LDP in the upper house elections, Prime Minister Hashimoto, accepted responsibility for the party's poor showing in the polls and stood down.¹²⁵ Mr Keizo Obuchi became Prime

122 Jiro Ushio, Chairman's Address for the 1998 Annual Meeting, Keizai Doyukai, 22 April 1998.

123 Transcript of Press Conference by Prime Minister Ryutaro Hashimoto at the closing of the 142nd Session of the Diet, 18 June 1998, <http://www.kantei.go.jp/foreign/980709press142.html> (19 October 1999).

124 Statement by the Minister of Finance, tentative translation, 19 June 1998.

125 Statement by Japanese Prime Minister Hashimoto, 13 July 1998 in Reference Documents as compiled in the *Foreign Policy Bulletin*, 2 July 1998 to 19 August 1998; Policy Speech by Prime Minister Keizo

Minister and on 30 July 1998 his administration was inaugurated. With great promise, he designated his cabinet the ‘Cabinet for Economic Revival’.¹²⁶

3.97 On assuming office, the new administration acknowledged that it must completely sweep away the systemic risks that had plagued Japan’s financial institutions over the past six years.¹²⁷ Prime Minister Obuchi’s immediate objective was to rebuild the financial system and restore confidence in the economy. He signalled the end to the government’s policy of fiscal restraint and in noting the serious state of the economy announced his decision to suspend the Fiscal Structural Reform Act.

3.98 Under Mr Obuchi, the government’s highest priority was to address the non-performing loan problem.¹²⁸ On 7 August 1998, he announced that he would implement the ‘Comprehensive Plan for Financial Revitalisation’ which would use public funds to rescue the financial system. The implementation of this plan was expected to:

...revitalise and stabilise the financial system, enable the financial system to restore its original function to provide necessary credit to economic activities, and restore international credibility.¹²⁹

3.99 The government was particularly anxious to introduce the ‘bridge or receiver bank’ scheme. This scheme would ensure that the business of failed banks would be promptly administered. New public banks would be established as bridge banks to ‘maintain loans to sound borrowers in good faith even if no private receiver bank appears’.¹³⁰

Obuchi to the 143rd Session of the Diet, <http://www.infojapan.org/announce/announce/1998/8/807-0.html> (2 June 1999).

126 Policy Speech by Prime Minister Keizo Obuchi to the 143rd Session of the Diet, 7 August 1998 <http://www.infojapan.org/announce/1998/8/807-0.html> (2 June 1999).

127 Speech by Minister Taichi Sakaiya, Sorbonne University, Paris, 7 January 1999.

128 Taichi Sakaiya, Minister of State, Director-General, Economic Planning Agency, Government of Japan, ‘The Present and Future of the Japanese Economy’, Singapore, 1 September 1999, <http://www.epa.go.jp/99/b19990903b-daijinkouen-e.html> (1 October 1999); Policy Speech by Prime Minister Keizo Obuchi to the 143rd Session of the Diet, 7 August 1998, <http://www.infojapan.org/announce/1998/8/807-0.html> (2 June 1999); Curtis J. Milhaupt, ‘Japan’s Experience with Deposit Insurance and Failing Banks: Implications for Financial Regulatory Design?’, Institute for Monetary and Economic Studies, Bank of Japan, *IMES Discussion Paper Series 99-E-8*, March 1999, pp. 23–4.

129 Comprehensive Plan for Financial Revitalization (1st Version), 23 June 1998, Government-Ruling Party Conference to Promote the Comprehensive Plan for Financial Revitalization, <http://202.32.34.2/foreign/980707fina-rev1.html> (19 October 1999); Policy Speech by Prime Minister Keizo Obuchi to the 143rd Session of the Diet, 7 August 1998, <http://www.infojapan.org/announce/1998/8/807-0.html> (2 June 1999).

130 Comprehensive Plan for Financial Revitalization (Second Report), 2 July 1998, <http://www.kantei.go.jp/foreign/980707fina-rev2.html> (19 October 1999).

3.100 Many officials now publicly acknowledged the magnitude and the urgency of the problems, particularly the troubled banking sector, confronting the Obuchi administration. The Economic Strategy Council of Japan submitted in the plainest language:

The Japanese economy has been in a most severe situation. It could be thought that the economy now faces the entrance of a vicious circle in which the worsening of the real economy, represented by a large decline in private demand, leads to the malfunctioning of the financial system, which then feeds back to the real economy adversely. The projection of economic growth rate for this fiscal year is forced to be revised down to almost minus 2 percent over the previous year. It would be difficult to exclude the possibility of negative growth, to a significant extent, in fiscal year 1999.¹³¹

3.101 On 16 October 1998, the Diet passed legislation to tackle the current financial situation—this was not a reform initiative but a bail-out package to recapitalise Japan's 'rotting banking system' and to safeguard depositors.¹³² It did nonetheless 'significantly redesign the governance of bank failure in Japan'.¹³³ In addition to the 17 trillion yen set aside to protect depositors, an 18 trillion yen fund was established to deal with failed financial institutions. A further 25 trillion yen was made available to facilitate the disposal of bad loans.¹³⁴

3.102 Overall, this package to revitalise the financial system amounted to around 60 trillion yen or 12% of GDP.¹³⁵ Under this scheme weak institutions were to be weeded-out but public funds would be used to help struggling but economically viable institutions survive and develop.¹³⁶ A formally independent Financial Revitalization Commission was to administer the system. It would identify insolvent banks and determine what appropriate action should be taken. Insolvent banks would either be operated by a public administrator as a bridge bank or be temporarily nationalised by placement under special public management.¹³⁷

131 The Economic Strategy Council of Japan, 'Recommendations for Short-Term Policies', 14 October 1998, <http://www.kantei.go.jp/foreign/981016recommend.html> (11 March 1999).

132 See Grant's Online, 'Japan to pass ¥60 trillion bank bailout legislation tonight', 15 October 1999, <http://www.grantspub.com/dispatch/0003.html> (15 October 1999).

133 Curtis J. Milhaupt, 'Japan's Experience with Deposit Insurance and Failing Banks: Implications for Financial Regulatory Design?', Institute for Monetary and Economic Studies, Bank of Japan, *IMES Discussion Paper Series 99-E-8*, March 1999, p. 25.

134 Monthly Economic Review, the *Suzuki Journal*, November 1998.

135 OECD, *OECD Economic Outlook*, no. 64, December 1998, <http://www.OECD.org/eco/out/eo64.htm> (20 May 1999).

136 Taichi Sakaiya, 'The Present and Future of the Japanese Economy', Singapore, 1 September 1999, <http://www.epa.go.jp/99/b/19990903b-daijinkouen-e.html> (1 October 1999).

137 Curtis J. Milhaupt, 'Japan's Experience with Deposit Insurance and Failing Banks: Implications for Financial Regulatory Design?', Institute for Monetary and Economic Studies, Bank of Japan, *IMES Discussion Paper Series 99-E-8*, March 1999, p. 26.

3.103 Although the primary concern was to redress the problem without further endangering the economy, the issue of the use of public funds to prop up large ailing banks sparked debate. Some critics feared that the infusion of public funds would merely keep failing banks on life support for another 12 months or so.¹³⁸ Mr Taichi Sakaiya, Director General of the Economic Planning Agency, defended the policy to prevent major bank failures:

It is clear that Japan's financial system suffers from a grave malady requiring swift surgery. But if that surgery involves the removal of too large an amount of tissue, the patient may die despite the excision of the diseased area. Some say that all the affected tissue must be cut out, no matter how much pain results from the operation. But unless we save the patient—the Japanese economy—we will have accomplished nothing.¹³⁹

3.104 He explained that if one bank folds, even the healthy businesses that have relied on it for loans will have difficulties in finding new sources of credit which might lead to such borrowers experiencing problems that could further result in job losses not only for that particular company but for suppliers and subcontractors. The damaging effects would continue to reverberate through the economy.¹⁴⁰

3.105 As Japan entered the final quarter for 1998, the urgency associated with reviving the ailing economy had not abated. The IMF in October 1998 reported that 'If the economy fails to respond as expected to programmed fiscal stimulus during the second half of 1998, the authorities should be prepared to take appropriate further action'. It stressed that the critical need at this stage was for Japan to reignite the process of economic recovery.¹⁴¹

Emergency economic package—November 1998

3.106 Acknowledging that the economy was in deep trouble, the Obuchi Government announced, in November 1998, an emergency economic package. This fiscal stimulus package of almost 17 trillion yen equivalent to around 3.0% of Japan's GDP was to help stabilise the financial system, counter the credit contraction and build confidence in the economy. With the inclusion of a permanent reduction in personal income taxation amounting to 4 trillion yen, the total scale of the package would exceed 20 trillion yen.¹⁴²

138 See Peter Landers, 'Moment of Truth', *Far Eastern Economic Review*, 18 February 1999, http://203.105.48.72/9902_18/p48finance.html (18 November 1999).

139 Sakaiya Taichi, 'Japan is Changing', *Japan Echo*, vol. 25, no. 6, December 1998, pp. 35–6.

140 Sakaiya Taichi, 'Japan is Changing', *Japan Echo*, vol. 25, no. 6, December 1998, p. 36.

141 IMF, *World Economic Outlook*, October 1998, Chapter IV, 'Japan's Economic Crisis and Policy Options', IMF, 1998, p. 117.

142 Ministry of Finance, Gist of the Emergency Economic Measures, <http://www.mof.jp/english/eem/eco001.htm> (25 May 1999) (page 2 of 3)

3.107 These emergency measures looked to restore public confidence in the economy and financial system by allocating the 17 trillion yen in the following way:

- 5.9 trillion yen to counteract the credit contraction by expanding the credit guarantee services of organisations and the lending facilities of government financial institutions;
- 8.1 trillion yen to social infrastructure in areas such as telecommunications and science and technology, the environment, social welfare, health and medical care and education;
- 1.2 trillion yen was to go toward the Housing Loan Corporation;
- 1.0 trillion toward the Comprehensive Plan to Create and Stabilise Employment, involving measures promoting the re-employment and expansion of occupational training; and
- 0.7 trillion for Regional Promotion Coupons to be distributed to families and recipients of old-age welfare pensions.¹⁴³

3.108 The growing preoccupation with the more immediate economic problems did not overshadow the need for structural reform. Although the focus on fiscal policy led some to worry that it might be neglected.¹⁴⁴

3.109 The government recognised that the Emergency Economic Package was a short-term urgent response. At the same time, it accepted that to secure medium and long-term growth, Japan needed to accelerate structural reform. The administration began to urge companies to cut back on white-collar over-employment, to streamline their supply structure in line with market needs and improve profitability. Minister Kaoru Yosano stated:

Despite the financial crisis, the financial Big Bang is moving steadily ahead according to the original schedule, and substantial progress has already been made, including abolition of the Large Stores Law, elimination of telecommunications charges permission, and elimination of supply and demand adjustment under the Petroleum Industry Law. However, Japan will need to continue to push deregulation forward strongly in a wide range of areas, including distribution, transportation, energy, medical care and communications, developing an environment conducive to cultivating the buds of new industries.¹⁴⁵

143 Outline of Emergency Economic Package, provisional translation by EPA, 1998; 'Gist of the Emergency Economic Measures', Ministry of Finance.

144 For example Keidanren stepped up its public campaign for reform insisting that structural reform of the economy and society was essential, and ridding the nation of the barriers of regulation particularly important. Keidanren, 'For the promotion of deregulation aimed at economic revival and the establishment of a transparent system of governmental management', *Basic Thinking*, 20 October 1998.

145 Kaoru Yosano, 'Japan's Challenge Toward the 21st Century', Speech at the Foreign Correspondents' Club of Japan, 18 December 1998.

3.110 As 1998 drew to a close, the Japanese Government was aware of the job ahead in lifting the economy from its debilitating slump and, despite the economic gloom, it boldly set three specific goals for the coming 1999 fiscal year:

- To achieve positive economic growth in fiscal 1999. The Japanese economy registered a negative growth rate of 0.4% during fiscal 1997 and current projects indicated that the economy would again contract by about 2.2% in fiscal 1998.
- To stop the upward trend in unemployment—4.4% in November 1998. The Prime Minister conceded that unemployment may temporarily rise even further as a result of economic fluctuations. Nonetheless, he stated that they were committing themselves to the position that Japan would not allow the unemployment rate for the entire fiscal 99 year to rise above the 4.4%.
- To promote greater international harmonization. The Prime Minister stated that Japan was committed to avoiding the intensification of trade and economic frictions and to revitalise the Asian economy.¹⁴⁶

3.111 Most economists agreed that Japan faced a daunting task in 1999 and predicted that it would mark the third year of negative growth.¹⁴⁷ The inability of officials to resolve the bad debt problem and the growing pessimism in both the household and corporate sectors about the ability of Japan to meet the challenges of a changing world sapped consumer confidence. The banking crisis went to the heart of Japan's economic troubles and a prompt resolution of this problem was seen as a prerequisite to establishing a durable economic recovery.¹⁴⁸ The OECD called for the immediate implementation of plans to restructure the banking system.¹⁴⁹

3.112 The budget proposal for FY1999, drafted with a priority on promoting economic recovery, was submitted to the Diet on 19 January 1999 and passed on 17 March, the most rapid approval in the postwar period.¹⁵⁰ This budget continued the efforts of government to stimulate growth in the economy. Again, the emphasis was on public works expenditure, programs to generate employment, initiatives to support

146 Speech by Minister Taichi Sakaiya, Sorbonne University, Paris, 7 January 1999.

147 The Japan Research Institute, Ltd, Economics Department, 'Prospects for the Japanese Economy, January 1999. See also The Economic Strategy Council, 'Strategies for Reviving the Japanese Economy' (Interim Report).

148 See statement by Michel Camdessus, Managing Director of the International Monetary Fund, Asia-Europe Finance Ministers Meeting, Frankfurt, Germany, 16 January 1999. Many other commentators reinforce this view that Japan must give top priority to cleaning up the bank mess. See Richard Katz, 'Economic Anorexia: Japan's Real Demand Problem', *Challenge*, March–April 1999, p. 92.

149 OECD, *OECD Economic Outlook*, No. 64, December 1998, <http://www.OECD.org/eco/out/ec64.htm> (16 March 1999).

150 Steady Approach for Economic Recovery, June 1999, <http://www.mof.go.jp/english/economic1.htm> (18 August 1999).

small and medium-sized enterprises (SMEs) and funding to encourage science and technology.¹⁵¹

3.113 Also during the first quarter of 1999, three tax reform bills were passed. This legislation lowered the highest marginal tax rate for individual income taxation from 65% to 50%; and reduced the standard rate of national corporation tax from 34.5% to 30%.¹⁵²

1999—Hint of recovery

3.114 By mid 1999, the Japanese economy showed signs of recovery. Real GDP grew an impressive 1.9% in January-March quarter showing positive growth for the first time in 6 quarters since the third quarter in 1997.¹⁵³ Economists welcomed this result as a hopeful departure ‘from the persistent shrinkage of the recent past’.¹⁵⁴ The Bank of Japan reported that the economy ‘had stopped deteriorating and corporate sentiment had improved’. It pointed out, however, that there was as yet no evidence of a ‘self-sustained recovery in private demand.’¹⁵⁵ Unemployment figures reached the worst-ever level of 4.8% in April 1999 with wages still trending downward and personal consumption remaining weak.¹⁵⁶ The government again emphasised the urgent need to restore confidence in the financial system.

3.115 As the year progressed, signs that the Japanese economy was no longer receding strengthened and anticipation for an economic recovery grew more hopeful. Nonetheless, fundamental problems needed to be addressed.¹⁵⁷ One analyst warned:

Despite the spread of rosy expectations on economic recovery at the moment, it is necessary to maintain a cautious stance on the outlook of the economy.¹⁵⁸

3.116 In support of this assessment, Mr Takashi Imai, Chairman of Keidanren, also noted that business executives could see the Japanese economy heading toward recovery but that economic growth to date was not self-sustained because corporate

151 Steady Approach for Economic Recovery, June 1999, <http://www.mof.go.jp/english/economic1.htm> (18 August 1999).

152 *ibid.*

153 Akio Makabe, Dai-ichi Kangyo Research Institute, *DKR Economic Report*, vol. 2, no. 7, 15 July 1999.

154 Mitsubishi Research Institute, *Outlook for the Japanese Economy in 1999 and 2000*, June 1999, http://www.mri.co.jp/news/press/99_0701_1e.html (26 August 1999).

155 The Bank of Japan, *Monthly Report of Recent Economic and Financial Developments*, July 1999.

156 Akio Makabe, Dai-ichi Kangyo Research Institute, *DKR Economic Report*, vol. 2, no. 7, 15 July 1999.

157 Taichi Sakaiya, ‘The Present and Future of the Japanese Economy’, Singapore, 1 September 1999.

158 Akio Makabe, General Manager, Financial Market Research Department, Dai-Ichi Kangyo Research Institute, Tokyo Report: ‘Will the Sun Rise in the Land of the Rising Yen? In *Economic Report*, vol. 2, no. 9, 15 September 1999, p. 2.

capital was still weak. He suggested that further fiscal and financial stimuli were needed.¹⁵⁹

3.117 The government was well aware that a pick up in private demand was critical to recovery. In October 1999, the Economic Planning Agency foreshadowed further government moves to lift private demand:

The Government will promptly decide on a comprehensive economic policy package, which will be a guideline for future economic management, and on the second supplementary FY 1999 budget. This is because the Government wishes to realise a smooth baton pass, toward a full-scale recovery, from public to private demand, while wiping out concerns that future weakening in public demand, among other things, may bring about an economic slowdown, and to establish a new solid foundation for economic development.¹⁶⁰

3.118 The government, however, adopted a ‘wait and see’ approach before deciding on whether to introduce another stimulus package. On 11 November 1999, as widely anticipated, it announced yet another economic rejuvenation package, worth between 17 and 18 trillion yen—‘the Economic Rebirth Package’. In introducing this new package as ‘highly attractive, brimming with originality, hope and appeal’, the government, nonetheless, acknowledged that private-sector demand remained weak despite the efforts of various policies. The aim of the package was to generate new demand to facilitate the smooth transition from public-sector-led growth to private-sector-led growth and to solidify the direction of Japan’s socio-economic structural reform.¹⁶¹

3.119 The plan targeted SMEs and venture firms for special support to encourage their growth and development. The package was also designed to promote technological innovation and to accelerate the deregulation process by frontloading the schedule of the Three-Year Program for Promoting Deregulation. Measures to address the unemployment problem and the ageing population were also included.

3.120 Despite being hailed as innovative and bold, the package contained many recycled proposals and the overarching goals remained those as stated many times previously. Opinion remains divided as to whether this package would provide the

159 Chairman Imai’s Press Conference, 4 October 1999, <http://www.keidanren.or.jp/english/speech/press/1999/1004.html> (20 October 1999).

160 Economic Planning Agency of Japan, Monthly Economic Report (October 1999), <http://www.epa.go.jp/geturei/1999oct.html> (20 October 1999).

161 Policy speech by Prime Minister Keizo Obuchi to the 146th Session of the Diet, 29 October 1999, <http://www.kantei.go.jp/foreign/souri/991029policy.html> (15 November 1999); Economic Planning Agency, ‘Principles of the Policy Measures for Economic Rebirth’, explanatory statement by Minister Taichi Sakaiya, provisional translation, 11 November 1999, <http://www.epa.go.jp/99/b/19991111b-taisaku-el.html> (15 November 1999); ‘Outline of the Policy Measures for Economic Rebirth’ (summary), 11 November 1999, <http://www.epa.go.jp/99/b/19991111b-taisaku-e2.html> (15 November 1999).

necessary impetus to invigorate an economy beginning to stir from its economic torpor.¹⁶²

3.121 In March 2000, the Bank of Japan was still insisting that there were no clear signs of a self-sustained recovery in private demand. This assessment was supported by figures showing a dismal performance for the October-December 1999 quarter in which the economy shrank 1.4%. This decline meant that Japan recorded negative growth for the second consecutive period slipping back into recession. Some analysts interpret this slump as a temporary phenomenon: others, as a continuing pattern of very low or negative economic growth.

3.122 Most recent projections are becoming more positive about Japan's recovery and have observed some lift in private demand. They have real GDP growing at 0.7–0.8% in 2000 and by 1.4% in 2001.¹⁶³ Even if this new 'rebirth' package together with the restructuring process succeeds in placing the Japanese economy on the road to recovery, serious economic problems remain to be tackled such as the enormous public debt and the continuing restructuring of the economy.¹⁶⁴

3.123 The OECD with a note of optimism predicted that once the nascent recovery takes a firmer hold 'an early start should be made to addressing the rapidly increasing medium-term public debt problem, the more so as demographic trends will put further pressures on Japan's fiscal position over the longer term'.¹⁶⁵ But great care should be taken to ensure that public expenditure provides some insurance against any weakening in private spending, and that the restructuring process stays on course and does not cause any serious erosion of consumer confidence. Even those who interpret the recent signs of recovery in the most encouraging light accept that the road ahead for Japan will not be an easy one.¹⁶⁶ Indeed, the Japanese economy must pass through a long and difficult rehabilitation period before it regains robust health.

3.124 At the beginning of April 2000, Prime Minister Obuchi became gravely ill and on 5 April Mr Yoshiro Mori took office as Prime Minister. He named his new administration the 'Cabinet for the Rebirth of Japan' and confirmed that he will continue to carry forward the domestic and international policies of the former Prime

162 *Australian Financial Review*, 12 November, 1999.

163 The Economist Intelligence Unit, *Country Report, Japan*, 1st quarter 2000, p. 3.

164 *NRI Quarterly Economic Outlook*, 17 March 2000, p. 25; *DKR Economic Report*, vol. 3, no. 5, 15 May 2000; *Monthly Report of Recent Economic and Financial Developments, (May 2000)* <http://www.boj.or.jp/en/siryosiryogp0005.htm> (9 June 2000). The EIU put gross national debt at well over 100% and stated that Japan now has the worst public figures in the industrialised world; The Economist Intelligence Unit, *Country Report, Japan*, 1st quarter 2000, p. 20.

165 *OECD Economic Outlook* no. 66, preliminary version, November 1999, <http://OECD.org/eco/out/Eo.html> (19 November 1999).

166 See Kaoru Yosano, 'Japan's Challenge Toward the 21st Century', Speech at the Foreign Correspondents' Club of Japan, 18 December 1998.

Minister.¹⁶⁷ He held his position as Japan's Prime Minister after elections for the Lower House on 25 June 2000.

3.125 Despite the doubts and uncertainty about Japan's future, there persists a deep seated belief within Japan that the country will eventually emerge from their economic troubles. It will, however, be a new Japan.

'The Japan of tomorrow' that has recovered from the present recession will not be a restoration of the Japan of days past. We shall witness the birth of an entirely new and spirited Japan that will continue to enjoy prosperity in the 21st century.¹⁶⁸

167 See Policy Speech by Prime Minister Yoshiro Mori to the 147th Session of the Diet, 7 April 2000, <http://www.kantei.go.jp/foreign/souri/mori/2000/0407policy.html> (9 June 2000); Taichi Sakaiya, Minister of State Economic Planning Agency, 'The Present and Future of the Japanese Economy', Speech at Yale University, May 2000, <http://www.epa.jp/2000/b/0505b-dajinkouen-e.html> (5 July 2000).

168 Taichi Sakaiya, 'The Present and Future of the Japanese Economy', Singapore, 1 September 1999.

CHAPTER 4

JAPAN—ON THE EDGE OF CHANGE

Economies are not static; they perpetually change. Changes in [an] economy cause deviations from predictions in supply and demand, and in the long run economic frameworks like institutions and customs no longer mesh with reality. In response to these changes, private enterprise, households and the government make adjustments, which then induce further changes in the economy. In this way, the real world economy continues to change, repeating the adjustment process from disequilibrium to equilibrium, and from a state with problems toward an optimal state.

Economic Planning Agency of Japan, 1994¹

The Japanese economy

4.1 Japan has reached a critical juncture in its development. For a number of years, its customs and institutions have ‘no longer meshed with reality’ and, even with the recent indications of an economic revival, it is yet to make that adjustment ‘from a state with problems toward an optimal state’.

4.2 Despite the many experts who have applied their minds to solving Japan’s economic problems, the country is still struggling, after many years of stagnation, to rehabilitate its economy and restore it to robust health. The implementation of initiatives on a number of policy fronts could not prevent Japan sliding further into recession in 1998. At the beginning of 1999, there were loud and strident calls for bolder action.² As the year progressed, the economy rallied but some analysts still held serious reservations about the soundness of the recovery. In October 1999, Keidanren, for example, declared that the Japanese economy was ‘undergoing the gravest crisis since the war’.³

4.3 The previous chapter chronicled the numerous measures taken by the Japanese Government to address the problems besetting the economy. In this chapter, the Committee looks behind the numerous recovery initiatives, rescue packages and the reform programs introduced after the asset-price bubble burst in 1990, to gain a better understanding of the forces driving economic change in Japan and the obstacles impeding its progress.

1 ‘Economic Survey of Japan (1993–1994)—A Challenge to New frontiers Beyond the Severe Adjustment Process’, Economic Planning Agency, Government of Japan, 26 July 1994, <http://www.epa.go.jp/e/doc/summary.html>.

2 OECD, ‘Japan Outlook’, *Observer*, no. 215, January 1999.

3 Keidanren, ‘Keidanren Urges the Government to Resolutely Carry Out Sweeping Regulatory Reforms’, 19 October 1999, <http://www.keidanren.or.jp/english/policy/pol107.html> (20 October 1999).

4.4 Between 1992 and November 1999, the government put in place several economic packages featuring fiscal spending measures and structural reform initiatives to help lift the economy from its slump and place it once again on a healthy growth path. At the beginning of 1999, eight years after the bubble economy collapsed, the outlook continued bleak with ‘four straight quarters of negative growth; two straight years of contraction of the macro economy; the steadily worsening disintegration of what used to be vaunted systems in the corporate sector; and growing anxiety about job security among the public’.⁴ Even with the encouraging signs of a recovery during 1999, the country has not yet set itself on a clear and determined path to economic growth.

4.5 Over the years, financial experts and politicians have had no difficulty in identifying broadly what needed to be done to return Japan’s economy to vigorous health and have called repeatedly for decisive action. In 1995, Mr Ryutaro Hashimoto, as Minister for International Trade and Industry, stated in general terms that ‘in order to stay ahead, an advanced economy must make constant efforts to respond to changing economic environments and explore unknown technological frontiers so that it may continue to find new sources of economic vitality’.⁵ Despite this observation and its wide acceptance, Japan has been unable to find that source of ‘economic vitality’.

4.6 In the same year, the Financial System Stabilization Committee and the Financial System Research Council recognised the need for Japan to construct a transparent financial system under which market mechanisms and the principle of self-responsibility of both banks and depositors would come fully into play.⁶ Again, despite the implementation of structural reform programs designed deliberately to restore credibility to Japan’s financial system, the country has been unable to rebuild an effective and vibrant financial sector able to win back the trust and confidence of the Japanese people.

4.7 The evidence shows that officials have a sharp appreciation of what needs to be done but they seem unable or reluctant to map out and put in place a workable strategy that would achieve their stated objectives. In brief, Mr Peter Hartcher told the Committee that the Japanese have a clear understanding of all their own dilemmas going back a long way. He noted, however, that despite the acute diagnosis, the highly developed dialogue and debate, the accurate perceptions and prescriptions—‘The

4 Economic Research Department, ‘The Third 18-Month Economic Forecast Using the STP Method’, NLI Research Institute, 1999, No. 124.

5 Ryutaro Hashimoto, Minister of International Trade and Industry, ‘Challenges for the World Economy in a Transitional Period and Development in the Asia-Pacific Region’, Vancouver, 2 May 1995, <http://www.jef.or.jp/news/challenge.html> (19 October 1998)

6 The Summary of the Final Report of the Financial System Stabilization Committee, the Financial System Research Council, 22 December 1995; Ryutaro Hashimoto, ‘Challenges for the World Economy in a Transitional Period and Development in the Asia-Pacific Region’, Vancouver, 2 May 1995.

problem is that nobody does anything about it'.⁷ In a similar vein, other commentators have spoken of an administration with a wait-and-see attitude and a policy of forbearance.⁸ Despite this perception of an administration unable to act decisively, the Japanese Government has taken numerous measures to rehabilitate the economy.

Stimulus packages

4.8 The efforts of government to boost the economy are most evident in the introduction of numerous well publicised rescue packages. In summary, between 1992 and the first half of 1998, the government put together a total of seven economic packages featuring fiscal spending and tax cuts for projects amounting to 80 trillion yen. In addition, in November 1998, the government approved an economic stimulus package of approximately 17 trillion yen, the largest in Japan's history. On cue, the government introduced more fiscal stimulus measures 12 months later. Unfortunately, the contribution of these fiscal stimulation initiatives to economic growth has not been as effective as hoped. Although the economy rallied during 1999, there is no current evidence to suggest that the stimulus packages have produced a return to solid and sustainable growth.⁹ Throughout the decade, domestic demand, despite the fiscal stimulus measures, has remained flat and unable to provide the necessary boost to reignite the economy.

4.9 Indeed, in October 1999, the Economic Planning Agency stated clearly the wish to see 'a smooth baton pass, toward full-scale recovery, from public to private demand'. But, while the government waits with baton in hand, there is no firm indication that the Japanese consumer is preparing for the hand-over. As late as May 2000, the Dai-Ichi Kangyo Research Institute observed that, although personal consumption was emerging from the 'free-fall' at the end of 1999, 'a full-fledged recovery in personal consumption is unlikely in view of the grim employment conditions and the restrictive stance taken by corporations toward personnel costs'.¹⁰

4.10 Clearly, Japan has yet to reach a stage where private-demand supports autonomous economic recovery.¹¹ Japanese consumers, by refusing to spend, have kept domestic demand depressed. There are a number of reasons why the stimulus packages have not provided the expected necessary impetus to economic growth.

7 Peter Hartcher, *Committee Hansard*, 15 April 1999, p. 335. See comments also by Professor David Reid, *Committee Hansard*, 25 February 1999, pp. 193 and 195; Professor Teresa Morris-Suzuki, *Committee Hansard*, 24 May 1999, pp. 606–7.

8 For example see Dr Christopher Rawlings, QCT Resources Ltd, *Committee Hansard*, 16 April 1999, p. 503, who stated that business was also reluctant to acknowledge the reality that the economy was turning bad.

9 For example see Bank of Japan, Reports and Statistics, *Monthly Report of Recent Economic and Financial Developments* (March 2000) (The Bank's View), 10 March 2000; Dai-Ichi Kangyo Research Institute, *DKR Economic Report*, vol. 3, no. 3, 15 March 2000, p. 2.

10 *DKR Economic Report*, vol. 3, no. 5, 15 May 2000, p. 2.

11 Economic Planning Agency, 'Outline of the Policy Measures for Economic Rebirth', (summary), 11 November 1999, <http://www.epa.go.jp/99/b/19991111b-taisaku-e2.html> (18 November 1999).

Inflated/overstated estimates of the size of the stimulus packages

4.11 Some analysts argued that despite the fanfare accompanying the announcement of the stimulus packages, the impressive sums quoted were misleading and the overall contribution made to invigorate the economy was, in practice, not as substantial as the figures would first suggest. Mr Adam Posen maintained that all announced fiscal packages were far smaller than claimed and, indeed, many budgets acted to reverse the effects of these programs. He stated:

Total public investment in all seven stimulus packages from 1992 through to spring 1998 was 23 trillion yen, about a third of the total amount announced, or 4.5% of GDP. While not a small sum, it seems hardly adequate after taking into account that there have been over 7 years of recession with an output loss in excess of 9% of GDP and that the claimed total public expenditures was 65–75 trillion yen.¹²

4.12 In supporting this view, senior economist, Jon Choy, pointed out that the actual increases in government spending often have fallen far short of the amounts pledged when the initiatives were announced. When comparing the stated value of the six stimulus packages between August 1992 and September 1995 with the actual supplementary budgets passed to implement them, there is a significant discrepancy. He argued that as a result of the modest contribution made by the stimulus packages:

Japanese financial markets as well as consumers and businesses have learned to discount what is announced and to look closely at actual spending and tax change—what is called *ma-mizu* (pure water, or the real amount of new stimulus)—to evaluate the potential consequences of a package.¹³

4.13 Despite the boast of a 16 trillion yen infusion of funds, the April 1998 package appears not to have carried the fiscal clout it supposedly was going to bring to the economy. In assessing this package, Professor Nariai Osamu found that ‘the effect of the stimulus package on the real economy comes to some ¥3 yen from public works, ¥1 yen from tax relief, and ¥2 yen from other measures, for a total of about ¥6 yen. This is only slightly over 1% of gross domestic product.’¹⁴

4.14 While the fiscal stimuli failed to encourage spending and thereby raise domestic demand, it did succeed, however, in increasing the short-term growth forecasts and kept the economy afloat. Some analysts saw merit in this approach. They argued that, by simply allowing the economy to tread water, the packages prevented the economy from sinking further. As Peter Hartcher noted:

12 Adam S. Posen, *Restoring Japan's Economic Growth*, Institute for International Economics, Washington, 1998, pp. 6, 28–32, 41.

13 Jon Choy, ‘Japanese Fiscal Policy: One Foot on the Gas, the Other Tied to the Brake’, *JEI Report No. 16A*, Japan Economic Institute, April 1998, pp. 8–9.

14 Nariai Osamu, ‘Restructuring in a Deflating Japanese Economy’, *Japan Echo*, August 1998, p. 39.

If you look at the various simulations that have been done concerning what might have happened to the level of activity in the Japanese economy without that fiscal stimulus, the chart would fall at a fairly depressing rate. GDP growth would decline fairly steeply. It would have been a bit of a train wreck if not for that stimulus. So it has had some utility.¹⁵

4.15 On the other hand, some were highly critical of this approach. Many analysts pointed out that the packages served more as a band-aid measure than a building block for sustained growth. They did not win back the confidence of consumers who refused to loosen their hold on the purse strings and they did not seize the imagination of the business community, which still balked at embarking on new enterprises.¹⁶

4.16 They maintained that by not providing the impetus needed to carry the economy out of troubled waters, it has languished while consumer confidence, already shaky, has been further eroded. Mr Adam Posen argued emphatically that ‘stimulus attempts that are solely intended to be sufficient to keep growth non negative are setting far too paltry a goal’.¹⁷

4.17 The most recent stimulus package of November 1999 followed the pattern established by its predecessors. The Economist Intelligence Unit suggested that the amount of spending was far less than the headline figure of around 18 trillion yen and was closer to 6.5 trillion yen, with the remaining sum largely repackaging of already allocated spending.¹⁸

4.18 Putting to one side the argument about the actual size and value of the stimulus packages and whether they were overstated or not, there were other factors that have undermined the effectiveness of the government’s fiscal stimulative policy. While the public funds injected into the economy may have prevented it from sliding further into trouble, many argued that the short-sightedness in planning and poor decision-making blunted their effectiveness and, overall, failed to provide an impetus to solid recovery.

Funding concrete

4.19 A considerable number of analysts, especially among the witnesses appearing before the Committee, criticised the lack of strategic economic planning in allocating the funds from the stimulus packages. At a time when the economy clearly needed a

15 Peter Hartcher, *Committee Hansard*, 15 April 1999, p. 329. DFAT argued that the Japanese economy would have contracted more sharply if not for the packages. Ms Karen Gilmour, DFAT, *Committee Hansard*, 15 February 1999, p. 10.

16 For example ABARE stated that ‘The consensus remains that this package (April 24) may only be sufficient to prevent the Japanese economy from slipping further into recession’, submission no. 21, p. 3.

17 See also, Jon Choy, ‘Japanese Fiscal Policy: One Foot on the Gas, the Other Tied to the Brake’, *JEI Report No. 16A*, 24 April 1998; Hiroko Ishii and Erika Wada, ‘Local Government Spending: Solving the Mystery of Japanese Fiscal Packages’, Institute for International Economics, Working Paper 98–5, <http://www.iie.com/98-5.htm> (15 October 1998).

18 The Economist Intelligence Unit, *Country Report*, Japan 1st quarter 2000, p. 19.

boost in economic activity that would provide the platform for future growth, the stimulus packages should have channelled money into areas best targeted to secure those foundations. As shown in the last chapter, business people, politicians, and academics recognised the need for innovation; for better managed and targeted research and development; for new enterprises that would take Japan into the next century. In the government's own words, it was looking to create new ventures that would lift the Japanese economy and carry it forward, moving from a manufacturing age to an information age. From all quarters, the business sector was being urged to think boldly, to show initiative and to be innovative: but funding available for new ventures was limited.

4.20 Many analysts pointed out that public works spending was not necessarily dedicated to projects that were either economically sound or productive in the long run. As late as November 1999, some were calling for an urgent reassessment of the current allocation of projects which 'no longer correspond to the changes in the economic environment and needs of the people'. They insisted that more emphasis must be given to cost-effectiveness and efficiency.¹⁹

4.21 Some highly critical analysts, such as Professor Gavan McCormack, argued that the characteristic of the public works agenda had been 'the capacity to think up a steady flow of projects of sufficient scale to warrant gargantuan outlays of public moneys'.²⁰

4.22 Thus, although the government did direct funds from the rescue packages into spending programs, the funding was funnelled into areas that did not address the pressing problem of consumer demand. Many people cited the large amounts of money that were squandered on the construction industry as the most glaring example of the misguided use of public money. Professor Robert Steven argued '...the big government expenditure program is going into concrete—Japan produces concrete...'²¹

4.23 Professor Steven suggested that the government should ensure that the packages give priority to consumption rather than investment demand. He explained that the funding going into public work stimulates a whole range of industries related to construction, such as iron and steel, but not 'the white goods industries, which would be consumer goods industries'.²²

19 For Example see Atsushi Takeda, 'Japan Needs More Public Investments and Another Economic Stimulus Package', *DKR Economic Report*, vol. 2, No. 11, 15 November 1999, p. 9.

20 Gavan McCormack, 'Is Japan Facing Financial Armageddon?', *New Asia Pacific Review*, vol. 3, no. 2 1997, p. 13.

21 Professor Robert Steven, *Committee Hansard*, 14 April 1999, p. 289.

22 Professor Robert Steven, *Committee Hansard*, 14 April 1999, p. 299.

4.24 Mr Peter McGill observed that national development and Keynesian pump-priming have long been cited as justifications for the injection of public money into the economy. He pointed out, however, that critics now charge that:

...public works projects are increasingly ineffective as economic stimulants, and serve largely as fodder for construction companies and as reward from politicians to their constituencies in a brazen exchange for votes. The visible result is that the Japanese archipelago has been inundated with public works of questionable utility. At vast expense of labor, technology and money, tunnels, suspension bridges, high-speed railway lines, expressways and airports have been built to connect small communities.²³

4.25 According to Mr McGill, the construction lobby in Japan was so powerful that it shrugged off even the most vociferous and well-founded criticism.²⁴ In Mr David Hale's words, fiscal stimulus in Japan meant 'just a lot of public works spending...basically campaign contributions to the Liberal Democratic Party.' Put succinctly, 'A lot of concrete has been poured into a lot of silly places...'²⁵

4.26 This policy of funding industries, such as the construction industry, not only propped up an industry unlikely to provide the necessary boost for economic recovery but also absorbed limited funds that could have gone toward areas with the potential to lift and sustain economic growth.

4.27 Mr Bradley Treadwell pointed out that domestic pump priming, particularly into areas such as construction, did not foster a vibrant efficient and competitive market and moreover it worked against change. He stated 'What you find traditionally under the current political system is a propensity to spend money on construction; new roads going nowhere, new shinkansen lines going up all over the place, and new mammoth bridges being built in particular areas.' For him there was no incentive for change.²⁶

4.28 Professor Osamu also noted the unnecessary wastefulness in not providing encouragement to areas with the potential to reinvigorate the economy:

When we look ahead to the twenty-first century and think about which industries will have the capacity to maintain a sustained expansion once again, we find that the construction industry will not be among them. But it is this industry that benefits when the government opens its purse, whether

23 Peter McGill, 'Paving Japan—the Construction Boondoggle', *Japan Quarterly*, October–December 1998, p. 40.

24 Peter McGill, 'Paving Japan—the Construction Boondoggle', *Japan Quarterly*, October–December 1998, p. 40.

25 David D. Hale, Global Chief Economist, Zurich Insurance Group, 'The Financial Crises in Japan and Asia: A Financial Insider's View', Japan Economic Institute Report, No. 36A, 25 September 1998, p. 3. See also Christopher Pokarier, *Committee Hansard*, 16 April 1999, p. 428.

26 Bradley Treadwell, Osborne Associates, *Committee Hansard*, 19 February 1999, p. 68.

the spending is called public works investment or dressed up in fancier terms, such as ‘industrial infrastructure installation’.²⁷

He made the point that such spending would only coddle an industry that desperately needs restructuring and went on to explain:

New demand-side measures designed to deliver short-term stimulus will make no contribution to the reforms Japan is most in need of. All they may do is preserve firms that have little competitive power. What is needed today is a clear sense of where Japan needs to go, along with a coherent set of policies for getting there.²⁸

Stimulus fatigue

4.29 The Japanese Government clearly articulated its intention to lift demand through its stimulus packages but its application was not supported by clear and well-directed plans. A distinct pattern emerged where, despite the short-term boost to the economy, the effects of the fiscal stimulus soon faded, enthusiasm waned and the economy relapsed into low or negative growth.

4.30 Thus, the credibility of the government’s fiscal policy was brought into question with the introduction of each stimulus package. Exaggerated statements concerning the real amount of stimulus, the inflated expectations generated by the overblown rhetoric and the concentration on public works construction that had become increasingly unproductive—roads, railroads, bridges to nowhere—had little effect in lifting consumer demand.²⁹

4.31 This loss of faith in the effectiveness of stimulus packages was very evident with the announcement of the April 1998 package. Despite being the largest fiscal stimulus package to that date, its reception was lukewarm. The Economist Intelligence Unit suggested that, by this time, the Japanese markets were suffering from ‘stimulus fatigue’. It noted that, even as the Prime Minister was announcing the package, the Nikkei average of 225 leading stocks listed on the first section of the Tokyo Stock Exchange dropped around 50 points and the yen fell against the dollar. Put bluntly, the investors were ‘simply no longer willing to accept the government’s statements at face value and wanted to hear details regarding how the money would be spent’.³⁰

27 Nariai Osamu, ‘Restructuring in a Deflating Japanese Economy’, *Japan Echo*, August 1998, p. 37. See also Comments of Professor Kazutoshi Kase, Tokyo University and Kenneth Curtis, transcript of ‘Dateline’, 5 June 2000.

28 Nariai Osamu, ‘Restructuring in a Deflating Japanese Economy’, *Japan Echo*, August 1998, p. 39.

29 Hugh Patrick, ‘The Causes of Japan’s Financial Crisis’, *Pacific Economic Papers*, no. 288, February 1999, p. 1.13. Just before the announcement of the November 1999 stimulus package a number of economists were calling on the government to introduce another stimulus package as the effect of the earlier ones would begin to taper off. See *DKR Economic Report* vol. 2, no. 11, 15 November 1999, pp. 8–9.

30 The Economist Intelligence Unit Ltd, *EIU Country Report*, 2nd Quarter, 1998, p. 19.

4.32 Keidanren also drew attention to a public and market place growing increasingly weary with the announcement of each record breaking stimulus package despite the mounting sense of urgency. It pointed out that these economic policy packages have remained powerless and their ineffectiveness has led to observations abroad that Japan is suffering from ‘package fatigue’. It pointed out that ‘The policy packages introduced up to now in 1998 have swollen to the size as large as ¥16 trillion, but the continued fall of the yen and share prices is indicative of how strong distrust of such packages has grown’.³¹

4.33 Clearly enthusiasm for the packages soon fizzled and people were becoming increasingly cynical with the government, and stale, recycled policies together with a lack of imagination and aggression in tackling the difficult economic situation. Jon Choy observed:

Fiscal stimulus plans have appeared with such clockwork regularity in the 1990s that each successive package somehow must be bigger or better to achieve the desired level of attention. Clearly, there is an upper limit to how much can be added to public works budgets. The ¥16 trillion edition may have hit this ceiling.³²

4.34 It did not. The November 1998 package, with the inclusion of a tax reduction measure, reached the record amount of over 20 trillion yen. Twelve months later, in anticipation that the effects of this package would taper off, the government announced its ‘Economic Rebirth Package’ worth close to 18 trillion yen. It was to be a breathtaking initiative that ‘responds to the expectations of the people of Japan and can be fully comprehended both in Japan and abroad’.³³ But one editorial greeted the initiative with disdain stating, ‘Removing the make-up, however, reveals a parade of the same old public works projects.’³⁴ In brief, the constant flow of stimulus packages not only reduced their ‘novelty and impact’ but also eroded the public’s trust in the competency of the administration.³⁵

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- 31 Keidanren, ‘A Prescription for the Revitalization of the Japanese Economy’, 23 October 1998, The 21st Century Public Policy Institute, <http://www.keidanren.or.jp/21ppi/english/policy/19981023/recommendation.html> (2 February 1999). Mr Manuel Panagiotopoulos also commented on the lack of enthusiasm for the packages—‘Even some of these meagre growth rates were achieved through massive injections of public funds, which, however, proved to have mainly short-term effects. It is more than likely that the latest such package, a combination of temporary tax cuts and public works will have a similar fate’, submission no. 9, p. 3.
- 32 Jon Choy, ‘Japanese Fiscal Policy: One Foot on the Gas, the Other Tied to the Brake’, *JEI Report No. 16A*, 24 April 1998, p. 11.
- 33 Policy speech by Prime Minister Keizo Obuchi to the 146th session of the Diet, 29 October 1999, <http://www.kantei.go.jp/foreign/souri/991029policy.html> (15 November 1999).
- 34 Editorial, *Asahi*, 12 November 1999, p. 5 in Daily Summary of Japanese Press, 16 November 1999, American Embassy Tokyo, <http://wnsv.iuj.ac.jp/subscription/DailySummary/0544.html> (18 November 1999).
- 35 Jon Choy, ‘Japanese Fiscal Policy: One Foot on the Gas, the Other Tied to the Brake’, *JEI Report No. 16A*, 24 April 1998.

4.35 While the implementation of fiscal stimulus packages since 1992 saved the economy by enabling it to mark time, the failure of these initiatives to put the economy back on a steady growth track fed scepticism about the continuation of this approach. This disenchantment with government policy, fuelled the already serious problem of low consumer confidence which translated into weak domestic demand.

Low consumer confidence

4.36 By adopting a fiscal expansionary policy, the government hoped to encourage and sustain domestic demand. To date, the policy has not worked. The lack of success in boosting consumer spending is not, however, attributable solely to shortcomings with the packages. Highly sceptical and with their confidence in the future shaken, people have deliberately chosen to save and not spend.³⁶ Mr Jim Storey summarised the situation:

As quickly as new money is introduced into the economy, consumers save it and capital-strapped banks refuse to lend out the new deposits, preferring instead to purchase government bonds.³⁷

4.37 Consumer confidence is fundamental to any economic recovery; it provides the necessary incentive for business to expand and grow. Once lost, it is difficult to rekindle and moreover to sustain but, once firmly in place, it is a very powerful and positive force.³⁸ Consumer confidence has been falling in Japan since the bubble economy burst. But even with some encouraging indications of an economic revival, the Bank of Japan concluded as late as March 2000 that there were no clear signs of a self-sustained recovery in private demand.³⁹ Two months later, the Bank reported that a rally has been observed in some areas of private demand but that 'it may take some time for households' income conditions to improve and, in turn, for private consumption to recover'.⁴⁰

4.38 This collapse in consumer confidence has created a strong reinforcing cycle of lower demand, falling sales, rising inventories, shrinking profits, lower wages and fear of unemployment which, in turn, breeds greater insecurity, further eroding consumer confidence. The cycle feeds upon itself. The more anxious the Japanese people become about their future, the more tightly they hold on to the purse strings and the longer domestic demand remains depressed.

36 See Professor David Reid, *Committee Hansard*, 25 February 1999, p. 192.

37 Jim Storey, Asia Pacific Foundation of Canada Round-table Report, 'Japan at the Crossroads?', March 1999, no. 9, p. 2.

38 See the ideas of Dr Helmut Sohmen, 'PBEC in a Changing World', 17 May 1999, PBEC: Speeches & Editorials: 1999, <http://www.pbec.org/speeches/1999/990517helmut.htm> (20 September 1999).

39 Bank of Japan, Monthly Report of Recent Economic and Financial Developments, January and March 2000, <http://www.boj.or.jp/en/siryo/siryo/gp9910.htm>.

40 Bank of Japan, Monthly Report of Recent Economic and Financial Developments (May 2000).

4.39 There are a number of forces at work in Japan giving rise to feelings of uncertainty and insecurity. Shifts in employment patterns and changing demographics with a falling birth rate and a rapidly ageing population have disturbed the status quo and present new challenges. These trends worry people, gnaw at their faith in the economy's ability to prosper and to provide for all. Thus many people, as well as preserving their existing savings, prefer to save any benefit from tax relief or additional earnings.⁴¹ The most immediate source of concern for the Japanese people is the high rate of unemployment.

Fear of unemployment

Unemployment rates

4.40 The unemployment rate in Japan has ranged from 3–3.5% in past years. In April 1998, however, the unemployment rate reached 4.1%, which was the worst result to that time since the figures were first calculated in 1953.⁴² More recently, due to the deepening recession, unemployment figures have continued to rise. They reached 4.3% in August and September 1998 until finally they climbed to a record high in June 1999 with the worst-ever figure of 4.9%.⁴³

4.41 The official unemployment figure may seem low but these statistics mask a more serious unemployment situation. It is generally assumed that the official rate underestimates the level of unemployment and does not indicate the extent of underemployment. Unofficial estimates put the Japanese jobless at a much higher rate since labour market practices in Japan mean that workers can be idle or virtually unemployed without appearing to be so in the official statistics.⁴⁴ A number of analysts also pointed out that Japan's official figures exclude many people who want jobs, but are not registered as job seekers.⁴⁵

4.42 On a practical level, the recession has reduced the incomes of many would-be consumers. The slowdown in production has resulted in a reduction in take home pay while falling corporate profits have kept bonuses from rising. Households have lost

41 See Christopher Pokarier, submission no. 10, p. 4 and *Committee Hansard*, 16 April 1999, p. 427.

42 Queensland Government, submission no. 18, p. 24.

43 JETRO, 'Japan's Economy Present Situation and Prospects, 1998'; Dai-ichi Kangyo Research Institute, *DKR Economic Report*, vol. 2, no. 10, 15 October 1999. Recent unemployment figures are: 4.9% for February and March 2000, and 4.8% for April 2000. See *DKR Economic Report*, vol. 3, no. 7, 15 July 2000, p. 10.

44 Luke Gower, 'What has Become of the Japanese Model?', *Agenda*, vol. 5, no. 1, 1998. See also Professor David Reid, *Committee Hansard*, 25 February 1999, p. 194; and Tadashi Nakamae, 'Japan's Impending Financial Crisis will Expedite the Necessary Shift of Resources from the Old to the New Economy', Presentation for the OECD Business and Industry Forum on Realising the Potential of the Service Economy: Facilitating Growth, Innovation and Competition, 28 September 1999.

45 Brink Lindsey and Aaron Lukas, 'Revisiting the "Revisionists": the Rise and Fall of the Japanese Economic Model', Centre for Trade Policy Studies, 31 July 1998. Yashiro Naohiro, 'Understanding Japan's Unemployment', *Japan Quarterly*, October–December 1998.

income from diminished casual and part-time employment opportunities, in particular, for female employees.⁴⁶ Mr Darryl McGarry submitted:

With full-employment, the regular provision of bonuses was a substantial and regular kick for the economy. With the economic downturn, the size of bonuses has been hit and increasingly bonuses have been done away with by corporations in response to tapered profitability while attempting to maintain the level of employment and remain in business.⁴⁷

4.43 Despite indications of a strengthening Japanese economy, the total amount of wages in 1999, even with an increase in overtime payments, was still declining because of the fall in bonus payments.⁴⁸ For a people accustomed to lifetime employment, the growing number of unemployed, together with the closure of businesses and the sale of assets, has a deeply negative influence on consumer sentiment.

Structural changes in the labour force

4.44 The employment situation in Japan is further complicated by economic, commercial and demographic pressures, which have led to structural changes in the workforce. These shifts in Japan's labour market have given rise to an unprecedented level of insecurity in the workplace.

4.45 After World War II, Japan built up an employment system whereby, once full-time employees were hired, they tended to remain with the company as a family member until they reached retirement age. Minister Taichi Sakaiya argued that this gave credence to the 'full employment myth' which held that Japan would never experience serious unemployment problems.⁴⁹ It gave the Japanese people a sense of security. During the 1990s, however, business was beginning to realise that lifetime employment, especially with practices such as wages based on seniority, was becoming 'a drag on Japanese production systems because they just cannot maintain an increasingly highly paid workforce at senior levels'.⁵⁰

46 Manuel Panagiotopoulos, submission no. 9, pp. 64–5; Christopher Pokarier, submission no. 10, pp.78–9.

47 Darryl McGarry, McGarry International Pty Ltd, supplementary submission no. 14A; also see *DKR Economic Report*, vol. 2, no. 11, 15 November 1999, p. 2.

48 Dai-Ichi Kangyo Research Institute, *Economic Report*, 15 October 1999, p. 2. JEI's Spin on the News, 8 October 1999 stated 'According to a mid-July survey of 1,164 firms by Nihon Keizai Shimbun, the average salaried Japanese worker's summer bonus was ¥720,046, a decline of nearly 5.8 percent from the year before. The drop was the largest since the leading Japanese economic daily began conducting such surveys in 1975 and was the first fall in five years...'

49 Taichi Sakaiya, 'The Present and Future of the Japanese economy', Singapore, 1 September 1999, <http://www.epa.go.jp/99/b/19990903b-daijinkouen-e.html> (1 October 1999).

50 Krishan Arun Radha, *Committee Hansard*, 24 February 1999, pp. 109–10. Mr Christopher Pokarier notes that lifetime employment is a misnomer; that the average retirement age for a core employee in a Japanese firm was between 52 and 55, and further that an employee could not access pension entitlements until 65, so a post retirement income position was important, *Committee Hansard*, 16 April 1999 p. 427. See also Professor Alan Rix, who noted that the notion of lifetime employment has gone

4.46 The corporate ‘hoarding’ of employees, where Japanese companies are likely to keep their workers on the payroll in recession even though it results in significantly lower profits, is another practice peculiar to Japan.⁵¹ But, as economic conditions have changed, such practices are being acknowledged as economically unsound and, despite a long tradition, the expectation of lifetime employment, a fundamental tenet of Japanese economic life, is being set aside. Companies, finding that they cannot survive in the market place without restructuring their workforce, are making the hard decision to retrench people. In simple terms, ‘the full employment myth has finally passed away’ leaving the Japanese people confused about shifting values and worried about future trends.⁵²

4.47 The employment situation in Japan certainly exposes the tension between strongly held traditional views and those of a new emerging corporate world where market forces and not time-honoured values such as loyalty and social responsibility dictate employment practices. Thus, at this time in Japan anxiety about job security is being heightened by a recession that has meant the shedding of jobs, the loss of overtime and reduced bonuses. The dismantling of a well-established and valued system of employment only further exacerbates people’s fears.

4.48 In such a climate of uncertainty, people will tend to be very cautious about spending. As long as they harbour misgivings about their future employment prospects, they will keep a watchful and nervous eye on their income and savings. Uncertainty ‘is paralysing individuals in their spending profile’; they will choose to stockpile rather than spend.⁵³ The current push for structural reform is simply fuelling the prevailing unease about Japan’s unemployment situation and, as a result, further dampening domestic demand.⁵⁴

and cited the retiring age as 53, *Committee Hansard*, 16 April 1999, p. 451; Hiroshi Nakano, Japan External Trade Organisation, Sydney Inc, *Committee Hansard*, 3 September 1999, pp. 787–8; Fuyuki Kitahara, Japan Chamber of Commerce and Industry, *Committee Hansard*, 3 September 1999, p. 808.

- 51 Yashiro Naohiro, ‘Understanding Japan’s Unemployment’, *Japan Quarterly*, October-December 1998.
- 52 Taichi Sakaiya, ‘The Present and Future of the Japanese Economy’, Singapore, 1 September 1999, <http://www.epa.go.jp/99/b/19990903b-daijinkouen-e.html>, (1 October 1999). The public acknowledgment of the end of this tradition is clearly spelt out in the November 1999 policy measures for Economic Rebirth which asserted that talent-based system and performance based system would be the guiding principle for employment practices. ‘Principles of the Policy Measures for Economic Rebirth’, explanatory statement by Minister Taichi Sakaiya, (provisional translation), 11 November 1999, <http://www.epa.go.jp/99/b/1999b-taisaku-el.html> (15 November 1999).
- 53 See Christopher Pokarier, *Committee Hansard*, 16 April 1999, p. 426; Dr Christopher Rawlings, QCT, *Committee Hansard*, 16 April 1999, p. 504.
- 54 See Susumu Taketomi, ‘The Current Economic Situation in Japan and its Future’, Bank of Japan, Speeches, Economic Seminar on the Japanese Economy in Bangkok, 29 June 1998, <http://www.boj.or.jp/en/press/koen023.htm> (18 January 1999). See also Christopher Pokarier, submission no. 10, pp. 3–4.

Ageing society

Demographic trends

4.49 The redefining of long-standing employment practices as well as the actual reshaping of the labour force is taking place as concerns about the ageing population are mounting. This combination only adds to people's worries.

4.50 Of major concern to the Japanese people are the demographic trends showing a declining birth rate, now at 1.38 children per female; an ageing of society; and a shrinking population. The population aged 65 and over will increase from 14.6% of the total population in 1995 to 26.9% in 2020 and 32.3% in 2050, the highest percentage in the world. Concomitantly, the productive population (ages 15 to 64) has been decreasing since peaking in 1995 and is estimated to fall 16% by 2020 and approximately 43% by 2050. The decline in birth rates combined with an ageing population is expected to have a major effect on Japan's macroeconomic environment.⁵⁵

4.51 The ageing of the population is progressing in Japan at a pace that is without parallel in the rest of the world. Such a trend suggests not only a decrease in the working population but also a rise in the public burden due to increased social security expenditures. Within two decades, the future ratio of workers to pensioners will be reduced by approximately half of the present level. Currently each elderly person in Japan is supported by slightly less than five working age persons. By the year 2015, Japan will have approximately 2.5 persons to support each elderly person and, by the year 2025, the ratio will drop to 2.2 persons. Clearly, the rate of dependency is increasing rapidly.⁵⁶ As summarised by economic journalist, Mr Luke Gower, 'Aging implies a rising dependency ratio, which will inflate expenditure on social security for the elderly and ultimately increase the tax burden'.⁵⁷

55 See General Survey, Bulletin, vol. 38, no. 9 September 1999. It stated that Japan's total fertility rate has continued to fall since 1973 when it reached 2.14 during the second baby boom. See also Arun Radha Krishan, 24 February 1999, *Committee Hansard*, p. 109; Fuyuki Kitahara, Japan Chamber of Commerce and Industry, Sydney Inc., *Committee Hansard*, 3 September 1999, p. 803; Dr Carolyn Stevens, *Committee Hansard*, 17 May 1999, p. 571. The Department of Family and Community Services gave the following predictions for the proportion of the population aged 65 and over from 7% in 1970, through about 15.4% in 1997 and 28% by 2030, Graeme Hope, Department of Family and Community Services, *Committee Hansard*, 21 June 1999, p. 745. See also Ministry of Health and Welfare, Section 1. The public Pension System: Its Significance and Mechanism, *White Paper*, http://www.mhw.go.jp/english/white_p/book1/p2_c2/c2_sect1.html (23 June 2000)

56 Commonwealth Department of Social Security, submission no. 19; p. 2. See also Jill Miller, *Committee Hansard*, 24 May 1999, p. 587; Department of Family and Community Services, *Committee Hansard*, p. 745. Yuichi Shionoya, 'Japan's Grand Reforms: From an Economic, Social and Political Perspective', Transcript of a speech delivered on 12 May 1997 at Asia Foundation and Public Policy Institute of California, http://www.infojapan.org_info/japan/socsec/shionoya.html (29 October 1999).

57 Luke Gower, 'What has Become of the Japanese Model?', *Agenda*, vol. 5, no. 1, 1998, p. 67. See also Professor Tessa Morris-Suzuki, submission no.3, pp. 3-4.

4.52 Thus, the ageing population is a major preoccupation for Japanese political and business leaders aware that it will have a significant effect on the welfare budget and government outlays as well as on the structure of the labour force and changing patterns in consumer demand.⁵⁸ The increasing welfare burden is of particular concern to the government, which is facing the responsibility for meeting the needs of an older population but with a shrinking revenue base as the labour force contracts. According to MITI:

...the consequent increase in such public burdens as taxes and social insurance premiums may weaken the international competitiveness of Japanese business corporations by pushing up wage costs and may eventually hamper the growth of the Japanese economy. Given such prospects, it is a matter of urgency that a system be established which will minimise the public burden.⁵⁹

4.53 The Japanese people are also worried about the effects of a rapidly ageing population. They have the longest average life expectancy in the world, 83 years for women and 77 years for men, and are acutely mindful of this fact. They are also aware of the trend towards population ageing with fewer children. But at the moment they do not feel confident that adequate measures are in place to ensure that they will be looked after in their retirement. Concerned about providing for an uncertain future, they prefer to save precisely at a time when increased consumption is needed to re-boot the economy.⁶⁰

4.54 According to Mr Christopher Pokarier, state-backed pensions and aged care facilities are limited and yet are still expected to become a major drain on public revenues at current contribution levels. It has been estimated that pension contributions will increase from their current level of 17.35% to 27% of monthly wages by 2015.⁶¹ The ailing financial system has also raised doubts about the soundness of private pension products. Mr Pokarier stated:

More generally, in the wake of the revealed failures of regulators to engage in adequate prudential supervision of banks and other financial institutions many Japanese citizens hold a residual fear for the security of private

58 For example see, Professor Alan Rix, *Committee Hansard*, 16 April 1999, p. 442.

59 Yashiro Naohiro, 'Need for Structural Reform of the Economy', *Journal of Japanese Trade & Industry*, no. 3 1998; General Affairs Division, Industrial Policy Bureau, Ministry of International Trade and Industry, 'An Outline of Economic Structure Reform', *Journal of Japanese Trade & Industry*, no. 3, 1998. On pensions see also Ryoichi Tsunematsu, Japan Chamber of Commerce, Sydney, Inc, *Committee Hansard*, 3 September 1999, p. 804.

60 Professor Tessa Morris-Suzuki, submission no. 3, p. 4. See Special Topic, Noriyasu Watanabe, 'Occupational Pension Systems in Japan', *Japan Labor Bulletin*, vol 37, no. 8, August 1998, <http://www.jil.go.jp/bulletin/year/1998/vol37-08/04.htm> (22 November 1999); Professor Akira Goto, *Committee Hansard*, 23 August 1999, p. 777.

61 Christopher Pokarier, submission no. 10, p. 4. See also Professor Tessa Morris-Suzuki, submission no. 3, p. 4; Charles Yuji Horioka, 'Japan's Public Pension System in the Twenty-First Century', Discussion Paper no. 482, Institute of Social and Economic Research, Osaka University, June 1999, p.21.

retirement funds. Amongst current retirees, extremely low interest rates means that people are consuming their capital and this contributing to not only their own sense of diminished wealth but of those who might inherit from them as well. Falls in land prices, which some people have used as a savings vehicle in response to the burden of inheritance taxes, have further exacerbated this sense of being less well off.⁶²

4.55 There is no doubt that people fear for their pensions. In particular, most Japanese private sector employees suspect that the corporate sector pensions that they had been expecting until just a few years ago are no longer deliverable.⁶³ They are also anxious about their jobs, and they know that the demographic trends pose problems for the future, giving rise to ‘a worried consumer sector’.⁶⁴ The government is acutely aware of the uncertainty and loss of confidence prevailing throughout the country. Minister Yosano stated:

The emphasis is thrown entirely on potential future risks to the general welfare of the people, such as health insurance and pensions, which together with the series of failures of major companies...has left the people of Japan with an extremely negative mindset.⁶⁵

4.56 While Japan’s changing demographic profile will result in a tightening labour market by the end of the decade, the uncertain prospects for many firms and industries in the short term continues to dampen consumer sentiment. The unease felt by many of Japan’s baby boomers about their financial prospects lies at the heart of the government’s repeated failed attempts to boost aggregate demand in Japan.⁶⁶

4.57 In summary, amid mounting uncertainty regarding the future of Japan’s economy, Japan’s household consumption has slumped while the savings rate has been increasing from 1990. A study by the Bank of Japan revealed the depth of concern in the community about the future of Japan’s economy. The middle-aged and elderly low-income households feel anxious about employment conditions; the young

62 Christopher Pokarier, submission no. 10, p. 4.

63 The EIU noted that there are fears that ‘many corporate pensions are now severely under-funded and unable to meet future obligations’. *The Economist Intelligence Unit’s Country Analysis, Japan*, 2000, p. 40. See also Olivia S. Mitchell, ‘Managing Pensions in the 21st Century: Design Innovations, Market Impact, and Regulatory Issues for Japan’, Pension Research Council, PRC WP 99–20, University of Pennsylvania, August 1999, p. 1.

64 Peter Hartcher, *Committee Hansard*, 15 April 1999, p. 326. See also Jill Miller, *Committee Hansard*, 24 May 1999, p. 587 and Ryoichi Tsunematsu, Japan Chamber of Commerce and Industry, Sydney Inc., *Committee Hansard*, 3 September 1999, p. 804.

65 Kaoru Yosano, ‘Japan’s Challenge Toward the 21st Century’, Speech at the Foreign Correspondents’ Club of Japan, 18 December 1998.

66 Christopher Pokarier, submission no. 10, p. 4; Professor Teresa Morris-Suzuki, *Committee Hansard*, 24 May 1999, p. 606.

households are worried about the pension systems and the elderly households are very concerned about nursing care.⁶⁷

4.58 This study concluded that people from a wide cross-section of the Japanese community are apprehensive about their future and that their fears touch specifically on their financial security and their ability to provide for themselves as they age. Clearly, the government has a major task in convincing the Japanese people that the economy will pick up, employment rates will rise, pension funds are both adequate and safe and that the nation can meet the needs of its elderly citizens.

4.59 The issue of aged care, in particular, is looming as a major problem for Japan. Official studies have suggested that the current national health insurance schemes are currently not viable at present charges against the projected growth in costs, despite the reform measures adopted that imposed additional costs on the elderly. The rising dependency ratio and the increasing welfare burden raises the question of whether or not Japan will be able to support the current level of social welfare benefits for its elderly population in the future. These issues have led to concerns about aged care facilities and health care and are a leading motivator behind the national emphasis on saving for the future.⁶⁸ The Ministry of Health and Welfare noted:

Today, the long-term care issue is the largest cause for concern of the Japanese people about their post-retirement life. In the year 2025, the continually aging population is predicted to make the number of people requiring long-term care to 2.6 times that in 1997, or 5.2 million people. Also, the period of time long-term care is required and the age of those caring for the elderly will increase. Therefore, long-term care for bedridden and senile elderly people will become a critical issue.⁶⁹

4.60 Ms Jill Miller told the Committee that the aged, who make up around 14 per cent of the population, account for 35 per cent of medical costs.⁷⁰ Mr Pokarier suggested that a more serious commitment by government to provide access to affordable aged care in the future and the immediate protection of the retirement savings of those who are now middle-aged might help boost consumer sentiment amongst those Japanese with the greatest capacity for discretionary spending. Put bluntly ‘It would certainly do more than continued public sector spending on infrastructure projects of dubious worth’.⁷¹

67 Shinobu Nakagawa, Bank of Japan, Research Papers, ‘Why has Japan’s Household Savings Rate Remained High even during the 1990?: Empirical Analysis on Risk Bias Viewed by the Characteristics of the Household Sector’, July 1999.

68 Queensland Government, submission no. 18, p. 23. See also The Japan Research Institute Ltd, Economics Department, ‘Prospects for the Japanese Economy’, January 1999, p. 5.

69 Ministry of Health and Welfare, ‘Structural Reform of the Social Security Programs for an Aged Society with Fewer Children: 1990–Present’, [1997] http://www.mhw.go.jp/english/ssp_inj_/services/6th.html (29 October 1999).

70 Jill Miller, *Committee Hansard*, 24 May 1999, p. 587.

71 Christopher Pokarier, submission no. 10, p. 5.

4.61 Mr Pokarier also drew attention to the problem of the escalating public debt, noting that further expansion of this debt to invigorate the economy might be largely self-defeating if ‘it is widely perceived that the government’s implicit underwriting of private savings and its capacity to invest in aged care are diminished’.⁷²

Government deficit

4.62 Although pushed from centre stage for the time being by the more pressing need to revitalise the economy, the nation’s public debt lurks menacingly in the wings as another serious problem.⁷³ This issue was openly discussed by officials during 1997 when the economy held promise of a recovery and the government had the confidence to air the matter of fiscal restructuring. At this time, Prime Minister Hashimoto made clear that:

With Japanese society aging at a pace unprecedented anywhere else in the world, if we leave the fiscal structure in its present state and invite further expansion of the fiscal deficit, the economy and welfare of the Japanese people in the 21st century will be destined for failure. Under these conditions, we must take every possible step and devote all efforts toward the realization of vitalized and prosperous lives for the Japanese people.⁷⁴

In the clearest of terms, he argued that if Japan did not reform its fiscal structure, it would pass on to its children ‘an unbearable burden’.⁷⁵

4.63 This situation has not changed. Indeed, the debt has continued to grow. Since the recession deepened in 1997, the urgent and immediate task of keeping the economy afloat has assumed precedence over considerations of public debt. The government looks to fiscal stimulation to rescue the economy.

72 Christopher Pokarier, submission no. 10, p. 5.

73 Professor Gavan McCormack is one of the most vocal analysts concerned about Japan’s large public debt. In 1997 he pointed out that ‘a level of public indebtedness running at around a quarter of any country’s GDP would be regarded as serious; in Japan’s case, it is more than one quarter of global GDP’. Gavan McCormack, ‘Is Japan Facing Financial Armageddon?’, *New Asia Pacific Review*, vol. 3, no. 2 1997, p. 10 and *Committee Hansard*, 24 May 1999, p. 617–19. He provided the following statistics to the Committee: the size of the debt comes to between ¥700 and ¥800 trillion, although some figures put it much higher...the national debt as a percentage of GDP was only 5% in 1965; 21% in 1975; 84% in 1995 and 102% in 1998. Austrade put the government deficit at about 110% to 120% of GDP, *Committee Hansard*, 27 May 1999, p. 643. Dr Aurelia George Mulgan agreed with Austrade’s figures stating that the Japanese government’s financial situation has reached a level of actual bankruptcy in which the accumulated fiscal deficit amounts to about 120% of GDP, *Committee Hansard*, 28 May 1999, p. 679. See also Professor Peter Drysdale, *Committee Hansard*, 23 August 1999, p. 764. Total gross debt of general government (which includes social security) is expected to reach about 114% of GDP in 2000; Peter Jarrett, ‘Japan’s economy: is the sun rising?’, *OECD Observer*, 27 January 2000.

74 Press conference by Prime Minister Ryutaro Hashimoto on the Final Report of the Conference on Fiscal Structural Reform, 3 June 1997.

75 Policy speech by Prime Minister Ryutaro Hashimoto to the 141st Session of the National Diet, 29 September 1997.

4.64 The IMF acknowledged the difficulty for Japan in reconciling the conflicting priorities of stimulating the economy and reducing government expenditure. In October 1998, it noted:

...the current need for fiscal stimulus has to be traded against the requirements for longer-term fiscal consolidation in anticipation of the pressures that will arise from population aging, particularly given that the surpluses in the social security accounts have recently been declining.⁷⁶

4.65 A year on, the problem of the mounting public debt still awaited attention. The OECD observed that ‘earlier counter-cyclical fiscal measures had led to a rapid and worrisome deterioration in public finances, with gross and net debt reaching historically high levels’.⁷⁷ In looking ahead, Mr Atsushi Takeda from the Dai-Ichi Kangyo Research Institute argued that the extremely high level of public investments resulting from the numerous economic stimulus packages must be corrected at some time. Without mincing words, he stated, ‘Should the unbridled fiscal expansion continue, a fiscal meltdown and a heavy burden upon future generations would become unavoidable.’⁷⁸

4.66 Nonetheless, the government remains committed to economic stimulus to revitalise the economy. Minister Taichi Sakaiya made this point clear when he explained Prime Minister Obuchi’s use of the ancient Japanese proverb, ‘He who hunts two hares loses both’ to explain his government’s policy.

The Prime Minister was often criticized for only chasing the hare of economic recovery with expansion of expenditure, so letting the fiscal deficit hare run wild. But I say this criticism was unwarranted. The two hares of economic recovery or economic rebirth and fiscal reconstruction are not running in different directions, but rather moving along the same course, and the Prime Minister was correct. We must first bag the hare of economic recovery and economic rebirth that lies just before us, and only then hunt down the hare of fiscal reconstruction that waits further down the path. If we abandon our economic rebirth measures halfway and rush to increase taxes and resist government expenditures, we surely lose both hares and come home empty-handed.⁷⁹

4.67 People are conscious of the growing deficit. Those saving for retirement realise that if the government borrows a lot of money—spends it—then eventually

76 IMF *World Economic Outlook, Financial Turbulence and the World Economy*, A Survey by the staff of the International Monetary Fund, October 1998, p. 117.

77 *OECD Economic Outlook*, no. 66, preliminary version, November 1999.

78 Atsushi Takeda, ‘Japan Needs More Public Investments and Another Economic Stimulus Package’, *DKR Economic Report*, vol. 2, no. 11, 15 November 1999, p. 9.

79 Taichi Sakaiya, Minister of State, Economic Planning Agency, Government of Japan, ‘The Present and Future of the Japanese Economy’, Speech at Yale University, New Haven, Connecticut, May 2000, <http://www.epa.go.jp/2000/b/0505b-daijinkouen-e.html> (5 July 2000).

they will have to raise taxes.⁸⁰ They are aware of the trend towards population ageing and fewer children and the increasing demand this will place on the welfare budget as well as the more immediate problem of the deteriorating fiscal situation. The government understands the need to address public concern over the future of the social security system.⁸¹ The Ministry of Health and Welfare acknowledged:

Japan's finances are in a grave situation. Amidst such a state, concerns are beginning to emerge that the burden of whatever scale the future of social security takes may likely become a limiting factor in maintaining an energetic society and economy.⁸²

4.68 For the moment, the issue of public debt may be kept in the shadows, but it remains another unresolved difficulty that plays on the minds of decision-makers and, more generally, troubles the Japanese people.

4.69 But at a time when the Japanese people are looking for reassurance about their long-term security, as they search for guarantees and look to their leaders for sound and strong leadership, they are disappointed. Scandals that have involved the bureaucracy, indecisive leadership, policy inconsistency, and mounting public debt only deepen their doubts about their futures. The government faces a difficult job in winning the confidence of a highly wary people, particularly in light of its own performance.

4.70 Without doubt, the people's trust in Japan's policy-makers has been seriously tested. Japan's leaders are yet to provide a clear or coherent vision of where they hope to take the country. But officials, academics, journalists and politicians are constantly reminding the people that the world is changing. They argue that Japan and its people must adjust if the nation is to retain its place as a leading economy in the coming decades. At this critical juncture in Japan's history, its leaders are still struggling to meet the challenges of reviving a sluggish economy in a changing world. The stream of fiscal stimulus packages introduced by the government, rather than offer some respite for an anxious people, have raised further doubts about the ability of the administration to deal with the difficulties ahead. Moreover, their failure to secure the full support and trust of the people on fiscal policy has been compounded by their failure to resolve problems in other areas. The response to the bad loan problem, for example, and their mishandling of sections of the banking system has generated further misgivings about the government's ability to come to grips with the economic problems facing the country.

80 Christopher Pokarier, *Committee Hansard*, 16 April 1999, p. 428; and submission no. 10, pp. 4–5.

81 Ministry of Health and Welfare, 'Structural Reform of the Social Security Programs for an Aged Society with Fewer Children: 1990–Present', http://www.mhw.go.jp/english/ssp_inj_services/6th.html (29 October 1999).

82 Ministry of Health and Welfare, 'Structural Reform of the Social Security Programs for an Aged Society with Fewer Children: 1990–Present', http://www.mhw.go.jp/english/ssp_inj_services/6th.html (29 October 1999).

4.71 Even in the face of crisis, the administration has responded slowly. The banking industry, which has provided a most glaring example of the ‘muddling on’ approach, has only recently felt the firm hand of government intervention on its shoulder. Despite the growing seriousness of the problem, the regulatory authorities failed to acknowledge the full magnitude of the banking crisis and were reluctant to act decisively to fund major financial restructuring.⁸³ In September 1998, the Governor of the Japan Bank voiced his irritation at the failure of government to put in place full disclosure of non-performing loans that were to him a prerequisite for disposing of bad debts and a necessary step to restore confidence in the economy. He stated, ‘I find it very frustrating to see this situation unrectified fully seven years after the collapse of the bubble economy’.⁸⁴

4.72 The Ministry of Finance, the primary regulatory agency, initially adopted a ‘forbearance policy’ toward the non-performing loan problem. Clinging to the hope of a quick economic recovery and an improvement in the real estate market, it allowed banks to hold non-performing loans without special write-offs.⁸⁵

4.73 Professor Freedman endorsed this view that the Ministry was out-of-touch. He told the Committee that despite the mounting crisis in the banking system:

The Ministry of Finance treated this sector with great gentleness reminiscent of a Japanese mother with a slightly wayward son...essentially, the belief was that the economic growth would wash away these temporary financial difficulties if officials could manage to muddle through and cover things up in the interim period.⁸⁶

4.74 Less charitably in July 1998, Mr Douglas Ostrom called this approach the ‘crossed-fingers strategy’ and argued that the Ministry of Finance adhered to this policy throughout the early to mid-1990s. Moreover, he suggested that they may still have their heads in the sand.⁸⁷

4.75 With hindsight, officials now recognise, in public at least, the folly in assuming that one way or another the economy, particularly the banking system, would right itself. Mr Taichi Sakaiya explained ‘...it was as if the managers of financial institutions and the bureaucrats responsible for supervising the financial

83 See for example, Michael Hutchison and Kathleen McDill, ‘Predicting Banking Crises: Japan’s Financial Crisis in International Comparison’, *Pacific Economic Papers*, no. 289, Australia-Japan Research Centre, March 1999, p. 22.

84 Masaru Hayami, ‘Issues Regarding the Japanese Financial System and Monetary Policy’, Bank of Japan, Governor’s Speeches, 11 September 1998.

85 See Thomas Cargill, Michael Hutchison and Takatoshi Ito, ‘Japanese reregulation: What You Should Know’, Japan Information Access Project, <http://www.nmjc.org/jiap/deregulate/papers/deregcon/hutchison.html> (1 March 1999).

86 Dr Craig Freedman, *Committee Hansard*, 15 April 1999, p. 342.

87 Douglas Ostrom, ‘Japan’s Banks and the Bad-Loan Problem: the Nightmare Continues’, Japan Economic Institute Report, No. 25A, 3 July 1998, p. 9.

industry were treating a festering internal infection, but relied on prayer because they were afraid to perform surgery'.⁸⁸

4.76 The neglect and mismanagement of this urgent banking problem certainly exposed a level of incompetence among some sections of the bureaucracy that only further damaged consumer confidence. The exposure of an underworld of corruption and scandal that touched a number of officials at the highest levels of the administration, however, proved far more disheartening for the people of Japan.

Scandals

4.77 For many years, authorities had turned a blind eye to the close relations between business and the bureaucracy; a relationship in which lavish rewards by corporations to government officials were a significant feature. By the late 1990s, a steady trickle of scandals involving officials at the highest levels of the bureaucracy came to public attention provoking open condemnation and finally government action.

4.78 Mr Edward Lincoln argued:

With the scandals that have emerged in the 1990s have come truly shocking revelations of indiscretion and malfeasance—shocking at least in the frequency of exposure; much of the revealed behaviour seems quite unsurprising.

...

These scandals have gone far beyond isolated incidents. They paint a picture of widespread routine corruption and incestuous relations among financial firms, their clients, government officials and politicians.⁸⁹

4.79 The uncovering in 1997 and 1998 of an 'entertainment-for-favour' practice demonstrated '...how Ministry of Finance mandarins wielded their discretionary powers to bend the rules of the marketplace and the extent to which bank and financial sector executives cultivated their bureaucratic relationships'.⁹⁰ According to Mr Michael Backman, it became apparent that:

...the nation's most prominent banks and insurance companies had systematically spent enormous sums on entertaining government bureaucrats in exchange for confidential information, tip-offs when bank

88 Taichi Sakaiya, Minister of State, Economic Planning Agency, Government of Japan, Speech at Centre for Strategic and International Studies, Washington D.C., April 1999.

89 Edward J. Lincoln, 'Japan's Economic Mess', a paper by Edward J. Lincoln, the Brookings Institution, presented to the Japan Economic Seminar, Washington, D.C., 25 April 1998, in *JEI Report, No. 18A*, 8 May 1998, pp. 6–7.

90 Ogino Hiroshi, 'Bureaucratic Prestige Imperilled by Selective Administration', *Japan Quarterly*, July-September, 1998.

inspections were about to be made, advance notice of changes to banking law, and helping conceal damaging records.⁹¹

4.80 In March 1998, there was the astonishing spectacle of prosecutors marching into the Bank of Japan to arrest a senior official suspected of trading inside information for expensive dinners and golf sessions. The Ministry of Finance suffered a similar loss of face when public investigators staged a raid on the Ministry's headquarters, seized papers and arrested two officials involved in regulating the banking sector. These officials were accused of giving the banks advance warning as to when to expect 'surprise' inspections in return for lavish entertainment and gifts. Although exposing the bureaucracy to public ridicule, these dramatic events at least signalled the government's intention to deal with this problem.⁹² In April 2000, the Prime Minister himself felt the need to state in Parliament that 'The recent series of improper acts perpetrated by civil servants is indeed truly deplorable.'⁹³ The startling disclosures of corruption and of the existence of a web of intrigue and collusion in the upper reaches of the Ministry of Finance and the nation's central bank have, without question, seriously dented their prestige.⁹⁴

4.81 Accusations of misconduct were also levelled at the business community. It suffered a serious loss of confidence in 1997 both within Japan and abroad because of the management failure in numerous corporations and the 'sokaiya' payoff scandals.⁹⁵ These scandals, involving a number of executives from two large and respected institutions, Nomura Securities and Dai-Ichi Kangyo Bank, confirmed that extortion was a problem among Japanese companies.⁹⁶

4.82 These revelations of bribery and corruption turned a harsh spotlight on the dark side of sections of the Japanese corporate and bureaucratic world. The unfolding tales of serious impropriety within the bureaucracy and business community

91 Michael Backman, *Asian Eclipse: Exposing the Dark Side of Business in Asia*, John Wiley & Sons (Asia) Pty Ltd, Singapore, 1999, p. 146.

92 Donald Macintyre, 'Ministries of Shame', *Time Asia*, vol. 151, no. 11, 23 March 1998; <http://cgi.pathfinder.com/time/asia/magazine/1998/980323/japan.html> (24 March 1999); Robert Uriu, 'Japan in 1998', *Asian Survey*, vol. 39, no. 1, January/February 1999, p. 117. There have been numerous articles written on this matter of corruption in the Japanese bureaucracy. See for example, Sandra Sugawara, 'For Japan Inc and its Regulators, the Dinner Date's Off', *Washington Post Foreign Service*, 11 April 1998; Ueda Atsushi, 'Neo-Bushido for Tomorrow's Japan', *Japan Echo*, vol. 25, no. 3, June 1998; Andrew Cornell, *Australian Financial Review*, 15 November 1999, p. 13.

93 Policy speech by Prime Minister Yoshiro Mori to the 147th Session of the Diet, 7 April 2000, <http://www.kantei.go.jp/foreign/souri/mori/2000/0407policy.html> (June 2000).

94 Ogino Hiroshi, 'Bureaucratic Prestige Imperilled by Selective Administration', *Japan Quarterly*, July-September, 1998.

95 Sam Jameson in 'Scandal hurts Big Bang reform', Asia Timesnet, 1 September 1997, defined sokaiya as a specialist—'someone who extorts money from companies in exchange for not revealing sensitive information about the firm or ask embarrassing questions at shareholders' meetings'. <http://web3.asia1.com.sg/timesnet/data/about/docs/as1403.html> (4 November 1999).

96 *ibid.*

diminished the people's trust in their leaders and has given rise to another cause for concern.⁹⁷

The push and pull for reform in Japan

Pressure to reform

4.83 In the face of all these difficulties—ailing economy, rising unemployment, rapidly ageing population, erosion of traditional values such as lifetime employment, poor leadership, corruption, mounting public debt and falling consumer confidence—Japan was being urged to reform.

4.84 The parlous state of the economy highlighted the urgent need for structural reform in Japan to facilitate its long-term economic development. Both Japanese and overseas analysts agree that the country can no longer look to its traditional industries and ways of doing business to generate growth. The United States, in particular, has been a consistent and vocal advocate for Japan to restructure its economy. It acknowledged that the government had boldly put forward a significant amount of fiscal stimulus to jumpstart the economy and also noted the government's 'very accommodative monetary policy'. But it went on to suggest:

Those are two legs to a stool of restoring prolonging economic growth. But there is a third leg missing, and without it we don't believe we can have sustained economic growth in Japan, and that is a serious restructuring of the Japanese economy, which means deregulating and reregulating and rechannelling the efforts of the Japanese economy and helping it move into the information age from the machinery age.⁹⁸

4.85 Many argued that early reform would immediately begin to restore confidence in the region and would be an enormous boost to the region's future economic prospects. They warned that if Japan's economic structure remained essentially unchanged, the economy would continue to flounder and even slip further behind.⁹⁹

Short-term dislocations versus long-term benefits

4.86 There is, however, a down side to such restructuring. It threatens to create short-term difficulties for and disruption to an economy already beset with problems. This presents Japan with a difficult trade-off—restructure with an eye to longer-range developments and future economic security but risk short-term upheavals, such as rising unemployment.

97 Yuichi Shionoya, 'Japan's Grand Reforms: From an Economic, Social and Political Perspective', Transcript of a speech delivered on 12 May 1997, at Asia Foundation and Public Policy Institute of California, http://www.infojapan.org/j_info/japan/socsec/sionoya.html.

98 Transcript: Deputy USTR Fisher, June 16 Worldnet Program on APEC, 17 June 1999.

99 DFAT, submission no. 32, p. 7.

4.87 Although concerned that reform would aggravate economic difficulties in the short term, the government, for the moment, has decided that the long-range advantages of restructuring outweigh the more immediate complications arising during the adjustment period. In outlining its policy measures for the November 1999 Economic Rebirth Package, the government emphasised that reform was an indispensable element in transforming the Japanese economy to the appropriate foundation for the knowledge-based age of the 21st century.

4.88 Having opted for change, Japanese leaders are now at pains to impress on the Japanese people the importance of restructuring. But their actions do not match the urgency of their words. As with the government's efforts to stimulate the economy through fiscal policy, it has demonstrated the same faltering and half-hearted approach to reform.

Progress slow

4.89 A recent assessment by the OECD of regulatory reform in Japan restated a common and long-held view that Japan needs to act rapidly and forcefully. It acknowledged the progress made in deregulation, but stated bluntly that Japan needs a 'sharp break with past regulatory practices'.¹⁰⁰ Despite all the talk about the pressing need to restructure, the government at first tinkered with reform; it responded with piecemeal measures and without determination. Although the Big Bang reforms in particular have given momentum to the reform initiatives, the Japanese Government is yet to formulate a well-defined template outlining the reform process. Put starkly by Mr Richard Katz in 1999, 'Japan is stuck. It can't maintain the old system, but it [is] not ready to embrace reform. It is drifting, trying to muddle through.'¹⁰¹

4.90 According to one economist, 'Deregulation has required the Japanese to rethink their extensive network of formal and informal controls imposed upon the economy. Change has been incremental, at best, with implementation lagging far behind prescription.'¹⁰² Mr Peter Hartcher also noted the lack of coherence and foresight in the reform process. He maintained that Japan is restructuring through crisis 'as market inevitabilities force themselves on reluctant policy makers and terrified politicians'. He considered that the depth of restructuring and of the transition point reached by the Japanese economy explains why Japanese consumers and employees are 'so traumatised and so reluctant to spend'.¹⁰³ He explained that this is why the recession is proving to be so deep and so intractable.

100 OECD, *Regulatory Reform in Japan*, Paris, 1999, pp. 11 and 16.

101 Richard Katz, 'Economic Anorexia: Japan's Real Demand Problem', *Challenge*, March-April 1999, p. 92. See also Philip Henry, Queensland Government, *Committee Hansard*, 16 April 1999, p. 409. Dr George Mulgan stated simply that the Japanese Government has been 'long on rhetoric and short on delivery', *Committee Hansard*, 28 May 1999, p. 673.

102 Lonny E. Carlie, 'Japanese Deregulation: What you should know', Centre for Japanese Studies, Asian Studies, University of Hawaii, Manoa, <http://www.nmjc.org/jiap/dereg/papers/deregcon/carlie.html>.

103 Peter Hartcher, *Committee Hansard*, 15 April 1999, p. 326.

The inertia of traditional systems—reluctance to change

4.91 Although this hesitancy in implementing reform clearly contradicts the acknowledged and stated need to restructure, it is understandable within the context of Japan's economic tradition. The roots of established practice and customs run deep in Japan, especially as they are anchored in many years of achievement. Despite the recent economic difficulties, there remains in Japan a stubborn reluctance to tamper with a proven system. The changes required are drastic. They demand a reassessment, a shift in approach and attitude, and a shedding of the practices of the past. The Japanese people, who emerged from a country devastated by war to build one of the leading economies in the world, value the economic system that has carried them to success. For them, it has been a source of economic prosperity and security—it is a familiar, proven and reliable system.

4.92 As Mr Hartcher pointed out, 'Success of the system has entrenched these arrangements very deeply in the system and made it extremely resistant to change.'¹⁰⁴ Thus many Japanese hold dearly to a way of thinking that is set in a period of bygone growth.¹⁰⁵ The government itself is finding it difficult to let go of past practices and ideas. A number of witnesses pointed out that the government basically mistrusts competition and is not yet prepared to put its faith in the free market.¹⁰⁶

4.93 This strong but natural inclination to stay with valued and successful traditions is heightened during times of uncertainty. Under stress, people look to the familiar for reassurance. Thus, despite the compelling argument for reform, the Japanese people still have an enduring attachment to the past ways of doing things. People recognise the need for reform but are as yet unwilling to embrace such change. Even though fears continue to grow for the future, many in Japan still hanker after time-honoured practices to allay their anxieties.

4.94 The Economist Intelligence Unit Report for the third quarter 1999 noted the degree of tension between accepting the need for change and a willingness to undertake such change. It acknowledged that there was a broad international consensus that Japan needs to tolerate higher levels of unemployment if its economy is to become more competitive and grow more quickly. In contrast, it maintained, however, that there was no general agreement among the Japanese people that this trade-off is worth making. Thus, according to the Unit, 'the political calculus militates

104 Peter Hartcher, *Committee Hansard*, 15 April 1999, p. 326.

105 Christopher Pokarier, *Committee Hansard*, 15 April 1999, p. 425.

106 Dr Aurelia George Mulgan, *Committee Hansard*, 28 May 1999, p. 675. See also See Stuart M. Chemtob, Special Counsel for International Antitrust Division, US Department of Justice, Keynote Address 'The Frustration and Promise of Japanese Deregulation', 4 April 1997, in Japan Information Access Project; Yasuo Kanzaki, 'Deregulation in Japan: Big Bang or Big Whimper', a talk delivered at the Woodrow Wilson International Centre for Scholars, the Smithsonian Institution, Washington, 7 March 1997.

in favour of politics that sustain the status quo, even if this delays a return to sustainable economic growth'.¹⁰⁷

4.95 A major concern is that the Japanese may postpone or merely play at reform until the situation deteriorates to such an extent that conditions will force their hand. As pointed out by DFAT:

We conclude that Japan is not on the verge of economic, political or social breakdown or dislocation. Its traditional systems are, however, under stress and there is as yet within Japan no broad consensus that radical change is necessary. While the prolonged economic slump have finally brought a sense of crisis in some quarters, the Japanese unsurprisingly, remain attached to traditional socio-economic practices which have brought them many benefits, especially to rural Japan. This is causing pressures and tensions in how Japan conducts itself internationally and how its leadership manages its domestic economic and political debate.¹⁰⁸

4.96 The Chairman of Keidanren recognised the desire by many to cling to established norms and proven practices. He accepted and sympathised with this inclination but warned of the danger in harbouring such tendencies. He told a gathering of journalists:

In some ways it is easier for all of us—politicians, government administrators, the general public and industry—to continue operating according to regulations that we know. However, circumstances are changing rapidly both in Japan and abroad, so it is no longer feasible to maintain existing regulations and the existing order, nor is it possible for those who support the status quo to persuade us to maintain them.¹⁰⁹

Complacency

4.97 Not only have the long years of economic progress in Japan engendered a degree of conservatism but it has also bred complacency. Hopes for Japan's recovery are buoyed by admiration for, and conviction in, the resilience of the people. There is a very real expectation that Japan's economy will eventually lurch back on track; an outlook, however, that encourages forbearance and blunts the drive for reform.

4.98 This complacency was most evident in the administration's dealing with the bad debt problems. The evidence has shown that, to a large measure, the government in particular and the financial system generally acted on the hope that the bad debt

107 The Economist Intelligence Unit Ltd, *EIU Country Report*, 3rd quarter 1999, p. 20. See also Mr Shinji Sato, 'English Translation of Minister Sato's Speech at the Foreign Correspondents' Club of Japan, 16 June 1997, who acknowledged that reform would generate friction within Japan. <http://www.miti.jp/press-e/f300001e.html> (24 April 2000)

108 DFAT, submission no. 32, p. 6.

109 Isao Nakauchi, Text of speech by Mr Isao Nakauchi, Vice Chairman of Keidanren, at the Foreign Correspondents' Club of Japan, 19 September 1994.

problem would eventually be resolved over time and were thus prepared to let the problem drift.¹¹⁰ As Minister Sakaiya said bluntly:

The managers and bureaucrats lacked the courage to decisively dispose of the bad debts, and simply prayed that land and stock prices would soon recover.¹¹¹

4.99 The grounds for assuming that Japan will be able pull itself out of this prolonged slump are strong. The country possesses a reservoir of rich talent, experience and values that could be tapped to carry it through this troubled time. Indeed, many commentators draw on the strengths in Japanese society and look with optimism to the future. As explained by DFAT, Japan is still the world's largest creditor nation; it has an economy based firmly on the cultural discipline of a high savings rate, its people are highly educated and motivated and they have a powerful work ethic, it has a strong manufacturing sector and a remarkable export performance which should provide the basis for strong economic growth beyond the short term.¹¹²

4.100 While most analysts would agree that Japan has the potential to return its economy to robust health, most would stress that there is no room for complacency. Rather, they would point to a pressing need for a determined and driving force to galvanise all sectors of the nation into concerted action.

Lack of urgency/commitment

4.101 Undoubtedly, the ability of the government to implement proposed reforms will be a decisive factor in the recovery.¹¹³ Unfortunately, there is no sense of urgency compelling Japan to usher in reform. Many commentators are concerned by this lack of political drive in Japan at this most critical time.¹¹⁴

4.102 Lack of aggression and timid leadership have undermined attempts by those sectors of the economy eager to marshal the resources of the country into a determined effort to reinvigorate the economy. For them, precious time has been and is being wasted. Clearly concerned about lost opportunities, Mr Robert Uriu wrote, 'While the country searched desperately for some sign of strong domestic leadership, such leadership was in short supply'.¹¹⁵ The wait-and-hope approach frustrated those committed to pushing ahead with reform and confirmed in the minds of many that the administration was not fully committed to change.

110 For example see comments by Professor David Allen, *Committee Hansard*, 25 February 1999, p. 188.

111 Taichi Sakaiya, Minister of State, Economic Planning Agency, Government of Japan, 'The Present and Future of the Japanese Economy', Speech at Yale University, Connecticut, US, May 2000, <http://www.epa.go.jp/2000/b/0505b-daijinkouen-e.html> (5 July 2000)

112 DFAT, submission no. 32, pp. 5, 7.

113 Dr Yasuo Takao, *Committee Hansard*, 24 February 1999, pp. 124–5.

114 See Terrence White, Australia-Japan Foundation, *Committee Hansard*, 19 February 1999, p. 42.

115 Robert Uriu, 'Japan in 1998', *Asian Survey*, vol. 39, no. 1, January/February 1999, p. 116.

4.103 Dr Yasuo Takeo noted that Japan does ‘not have the kind of overwhelming power to usher in a transformation of Japanese society’.¹¹⁶ According to Mr Larry Crump, from Griffith University, Queensland, ‘The government of Japan, behaving in a very Japanese way, has taken the safe approach and not done very much’.¹¹⁷

4.104 A reticence to tackle difficult problems seems to be at the very heart of the administration’s failure to launch a successful reform program. The government has tinkered with reforms but stopped short when tough decisions had to be made. Akira Kawamoto accepted the argument that the reform plan lacks a firm political hand to drive it forward and give it overall shape and coherence.¹¹⁸

4.105 The Queensland Government, for example, questioned the determination of the Japanese officials to implement the financial system reform. As an indication of this lack of commitment, it noted the Japanese Government’s intervention in the stock market in 1997 to protect Japanese banks and the legislative schedule which suggests that changes are not coming into force until as late as 2001.¹¹⁹

4.106 The United States was particularly concerned with the Japanese Government’s unwillingness to move ahead, boldly and decisively, with reform. It stated:

But what we do not see yet is a commitment by the Japanese government to move away from a command-and-control mentality to a government that encourages competition.

...

What we worry about is that Japan cannot make the transformation to the information age.¹²⁰

4.107 This lukewarm commitment to reform also manifests itself in the government’s inability to put together a credible reform plan. It will respond when pushed but there is no long-term vision and no overarching architecture to guide progress in the restructuring process. Mr Arun Rhada Krishnan drew attention to the way the reforms have been pursued in small bits—‘tax concessions here, pump priming here, fighting fires as they arise and so on—they do not seem to present a long-term kind of picture’.¹²¹ Professor Karel Van Wolferen stated simply:

116 Dr Yasuo Takao, *Committee Hansard*, 24 February 1999, p. 124.

117 Larry Crump, *Committee Hansard*, 16 April 1999, p. 473.

118 Akira Kawamoto, ‘Unblocking Japanese Reform’, *OECD Observer*, 2 April 1999, <http://www.oecdobserver.org/news/fullstory.php3?aid=5> (25 October 1999).

119 Queensland Government, submission no. 18, p. 8.

120 Transcript: Deputy USTR Fisher, June 16 Worldnet Program on APEC, 17 June 1999.

121 Arun Radha Krishnan, *Committee Hansard*, 24 February 1999, p. 108.

When you ask Japanese government officials: what actually does your policy look like?—nobody can really give you a succinct answer and tell you this is where they are heading.¹²²

4.108 As late as June 2000, doubts still lingered about the ability of Japanese leaders to formulate a comprehensive reform program that would tackle some of the most serious economic problems. Ambassador Ove Juul Jorgensen, Head of the Delegation of the European Commission in Japan, in assessing the regulatory reform process in Japan stated:

The revised Programme is, as far as we are concerned, still rather patchy. For example, competition policy plays a greater role than ever in the Programme, but the measures promised are still basically ‘nibbling around the edges’. Effective competition policy enforcement could resolve many of Japan’s regulatory reform bottlenecks in one fell swoop.¹²³

4.109 Many commentators share misgivings about the government’s ad hoc response to reform and its capacity to carry out the more difficult reforms that lay ahead.¹²⁴ Austrade could imagine ‘a scenario in which Japan undertakes some reforms but leaves the major part of its economic institutions and relationships basically intact’.¹²⁵ It suggested:

The more likely outcome will be that Japan will implement some reforms, largely in response to a major crisis brought on by internal, or more likely external, pressure leaving intact many of the existing relationships and institutions.¹²⁶

4.110 The evidence shows that the government has fallen short on two major fronts in pushing forward with a successful reform program. First, to give an absolute and unequivocal commitment to the reform process. Second, on a practical level, to put together a coherent and logical plan that marks out the steps toward a well-defined

122 Karel Van Wolferen, Professor for Comparative, Political and Economic Institutions, University of Amsterdam, Holland, Transcript of Television Programme, ‘Lateline’, 2 November 1999.

123 Presentation by Ambassador Ove Juul Jorgensen, Head of the Delegation of the European Commission in Japan, Tokyo, 6 June 2000, <http://jpn.cec.eu.int/english/press-info/4-2-48.htm> (8 June 2000).

124 Akira Kawamoto, ‘Unblocking Japanese Reform’, *OECD Observer*, 2 April 1999, <http://www.oecdobserver.org/news/fullstory.php3?aid=5> (25 October 1999). See also Professor Karel van Wolferen, transcript, ‘Lateline’, 2 November 1999; and Yoshio Ichiryu and Yuji Hosoya, MITI/RI Discussion Paper no. 98-DOF-29, ‘New Developments in Economic Policy: Complementarity between Government and the Market Place’, September 1998, p. 24.

125 Austrade, submission no. 35, p. 3.

126 Austrade, submission no. 35, p. 10. See also Douglas Ostrom, *JEI Report*, no. 20—19 May 1999, ‘Corporate Japan’s restructuring Efforts: A Progress Report’, <http://www.jei.org/Reports?JEOR/00JEIRsummaries/s0020.html> (8 June 2000); and article ‘A New Japan?’ in *Businessweek on Line*, 25 October 1999, which was also concerned that the Japanese establishment ‘will still find a way to preserve its cloistered economy’ and that reform may well be ‘just enough to prevent another real crisis’, http://businessweek.competition/1999/99_43/b3652010.htm?scriptFramed (8 June 2000).

goal. In essence, the administration must provide the motivation for change and show that it is prepared to act boldly in implementing reform as well as provide a clear sense of direction.

Structural impediments

4.111 The government is not alone in frustrating the effective introduction of structural reform. The leadership problem and the lack of heart for reform also permeates the administration. The bureaucracy carries a primary responsibility for formulating and implementing deregulatory initiatives but their contribution to the reform process has been limited.

4.112 Japan's bureaucracy has lost its authority. With their record for economic management in tatters and their reputation as upright public servants tarnished, Japanese public servants have retreated into the background. Mr Pokarier maintained that basically, 'the markets and individuals discount anything public officials say these days because they have heard it all before'.¹²⁷ They have become increasingly reluctant to take risks thus making policy formulation more difficult. One commentator observed:

With public attention focusing on their past failures, bureaucrats have great incentives to avoid further policy mistakes. In addition, turmoil in the political arena makes the bureaucrats more cautious: absent strong political leadership and direction, bureaucrats are reluctant to advocate bold actions or solutions. In short, those who have been expecting new policy directions from the bureaucracy are likely to continue to be disappointed.¹²⁸

The bureaucracy—protecting their patch

4.113 But there is a far more potent force within the bureaucracy stifling any move for reform—conflict of interest. In essence, the process of deregulation rests with the regulators themselves. Over time members of the bureaucracy have built up a system that serves their interests and they resist measures likely to weaken their influence. Messrs Lonny Carlie and Mark Tilton, were not alone in voicing their scepticism at the sincerity of the motives behind the reform measures. They wrote in 1996, 'As presently constituted, deregulation is being advanced largely at the discretion of the bureaucracy—the very party whose powers would be reduced by the process—and for that reason it is unlikely to be pushed forward with great enthusiasm or haste'.¹²⁹

4.114 Dr George Mulgan reinforced this point. She maintained that because each ministry or agency has the primary responsibility for deregulation they decide what is relevant or redundant. She stressed:

127 Christopher Pokarier, *Committee Hansard*, 16 April 1999, p. 426.

128 Robert Uriu, 'Japan in 1998', *Asian Survey*, vol. 39, no. 1, January/February 1999, p. 117. See also 'The Japan Puzzle', the *Economist*, 21 March 1998, p. 24.

129 Lonny Carlie, Mark Tilton, 'Japan's Deregulation "Action Plan" and the Deregulation', Japan Information Access Project, April/May 1996.

As a result, it is possible for ministry officials to keep major regulatory powers unto themselves by relinquishing those that are less central to their own interests and to slow the pace of change by offering up only small numbers of reforms at each step in the deregulation process...¹³⁰

4.115 With the interests of the bureaucracy intertwined in the regulatory process; officials would have to measure any deregulatory proposal against its potential to harm their interests and thus would tend to favour the status quo.¹³¹

The iron triangle

4.116 But this self-interest has another dimension. Not only are separate elements within the economic system such as government and sectors of the bureaucracy pulling against reform but there is a fusion of interests of government, business and the bureaucracy, sometimes referred to as Japan Inc., blocking change. This powerful interlocking of mutual interests has led to the entrenchment of an economic system where each element within the system cooperates with the other in preserving and further promoting their benefits.

4.117 In arguing this point, Dr George Mulgan explained that the three primary sets of beneficiaries—the authorised participants (producers and/or other business interests making administratively-sanctioned profits), bureaucrats (maintaining untrammelled regulatory powers and retirement jobs in semi-governmental regulatory institutions and private sector business) and politicians (obtaining political funding from protected industries)—form an iron triangle with a strong common interest in resisting pressure for change.

4.118 She argued:

The lack of enthusiasm for deregulation amongst many Japanese politicians derives from their interdependency relationship with the vested interests which have grown up around the rents and benefits that regulatory systems provide...sectoral interests rely on politicians to act as brokers on their behalf in order to extract, maintain or increase rents and income supports from administrators. The most powerful brokers cluster together in LDP policy tribes (*zoku*) with connections to specific sets of sectoral interests, and with the connivance of the bureaucracy, harness rents and other benefits as political goods for distribution to their supporters. In exchange they receive electoral goods such as political funding and voting support.¹³²

130 Dr Aurelia George Mulgan, submission no. 20, p. 23.

131 Dr Aurelia George Mulgan, submission no. 20, p. 22.

132 Dr Aurelia George Mulgan, submission no. 20, p. 19.

She further noted that ‘While Diet members might express support for deregulation as a general principle, if a particular item of deregulation appears to threaten an interest they represent, they will staunchly oppose it’.¹³³

4.119 As this interdependency between the distinct economic entities evolved into a stable and long-term structure, so did a support network of sub-structures that further buttress and entrench the system. Inter-company relationships, cross-shareholdings, a main bank system, labour-management relations, the legal framework and a regulatory system that includes administrative guidance work to lock-in the present system.¹³⁴

4.120 Witnesses agreed that a political-bureaucratic-vested interest triangle is at the very centre of all Japanese regulatory systems and obstructs far-reaching efforts to deregulate the Japanese economy. They argued that regulation encouraged collusion between bureaucratic regulators and protected industries by institutionalising their common interests.¹³⁵ Dr George Mulgan noted:

...integral to regulatory regimes are the numerous extra-ministerial groups (*gaikaku dantai*) and public corporations spawned by the ministries and agencies of government...In most cases, these groups established on the basis of regulations provide lucrative post-retirement posts for officials through the process of ‘descending from heaven’.¹³⁶

4.121 The intricate, strong and wide-ranging web of interdependency between the various components of the economic system make it impervious to outside pressure to change. As Michael Backman explained:

The nexus between big business, the bureaucracy, and the LDP is one that is complex and mutually reinforcing—so much so that it is scarcely possible to treat each of the three as distinct entities. And the mutually reinforcing nature of the relationships means that attempts to reform any one pillar of the structure represent a direct attack on all the sections. It simply isn’t possible to rope off one part of Japan Inc., remodel it, and then move on to the next part. The interconnectedness of the system of client-patron relationships means that it is all or nothing. So any attempt at reform, even if

133 Dr Aurelia George Mulgan, submission no. 20, pp. 19–20.

134 Akira Kawamoto, ‘Unblocking Japanese Reform’, *OECD Observer*, 2 April 1999, <http://www.oecdobserver.org/news/fullstory.php3?aid=5> (25 October 1999).

135 Dr Aurelia George Mulgan, submission no. 20, pp. 19–20. Mr Pokarier supported this view—‘Japanese firms have responded rationally to the regulatory settings within which they find themselves. Many have typically through their industry associations, also made investments in political processes aimed at securing the regulatory settings that served their own immediate interests but which have imposed costs on other, politically less well organised groups.’ See submission no. 10, p. 8; and ‘Corporate Efforts to Promote Deregulation’, text of speech given by Mr Isao Nakauchi, Vice Chairman of Keidanren, at the Foreign Correspondents’ Club of Japan, 19 September 1994, <http://www.keidanren.or.jp/english/policy/pol001.html>.

136 Dr Aurelia George Mulgan, submission no. 20, p. 20.

relatively minor, is met with resistance from the entire establishment as each part moves to safeguard its self-interest.¹³⁷

Agriculture—vested interests meld with tradition values

4.122 Within Japan's political system, farmers have stood out as a particularly powerful sector. Many agricultural organisations, particularly Nokyo, are directly represented in the Diet by politicians who hold or have held official positions in the agricultural cooperatives and who are expected to deliver benefits to their agricultural supporters.¹³⁸ This sector also shows how strongly vested interests and traditional beliefs are interlocked and mutually reinforcing in Japan's economic structure.

Reform in the face of opposition

Chinks in the armour

4.123 The iron triangle stands as a major obstacle to reform in Japan. Despite its ability to resist outside influences, the pressure for change is starting to weigh heavily on this formidable power structure. The three elements to the triangle are beginning to buckle under the forces pushing for change.

4.124 First, the bureaucracy, which has strongly resisted reform in its endeavour to head off any encroachment on its power is showing signs of strain. The links between the administration and business, so long regarded as integral to the success of the economic system, are now seen as a liability and an obstacle to the development of the economy.

4.125 The growing public awareness of the failings within the administration poses a threat to its cosy world. The exposure of impropriety has eroded its credibility and given weight to public criticism.¹³⁹ Clearly, the bureaucracy has lost status. Scandals involving some bureaucrats have tarnished the aura of distinction they once enjoyed and diminished their stature as public servants who put the national interest above their own.¹⁴⁰ This power group is no longer above reproach, and has had to suffer the indignity of public probing into its affairs. With its competency in doubt and its probity under question, it seems likely that the bureaucracy will be more receptive to

137 Michael Backman, *Asian Eclipse*, John Wiley & Sons (Asia) Pty Ltd, Singapore, 1999.

138 Dr Aurelia George Mulgan, submission no. 20, p. 8.

139 Ogino Hiroshi, 'Bureaucratic Prestige Imperilled by Selective Administration', *Japan Quarterly*, July–September 1998, p. 9.

140 Robert Uriu, 'Japan in 1998', *Asian Survey*, vol. 39, no. 1, January/February 1999, p. 117. See also, Sakaiya Taichi, 'The Myth of the Competent Bureaucrat', *Japan Echo*, vol. 25, no. 4, February 1998; and Yoshihisa Murasawa, 'Corporate governance: the turmoil continues', *Euro-Japanese Journal*, vol. 5, no. 1, Summer, 1998, p. 18.

change—more likely to bow to pressure than resist it.¹⁴¹ In summary, the growing distrust of elite bureaucrats is eroding this major barrier to the reform process.¹⁴²

Practical business—surviving in the market place

4.126 Secondly, the belief that the economy must be released from old managerial practices is strengthening. The perception of Japan's economic system as outmoded and in need of reform is becoming sharper. The Japanese people are beginning to question the deeply ingrained 'production first' and anti-competition principles introduced with Japan's 'catch-up' system.¹⁴³

4.127 Tolerance for the coddled domestic sector of Japan's two-tiered economy is wearing thin. International highly productive companies are no longer prepared to carry the protected home industries that enjoy special benefits under a huge array of rules and regulations. Such practices drive up production costs and undermine the competitiveness of successful export industries. In Japan, the market place is driving reform as shown earlier in the move away from seniority-based wages and lifetime employment. Market forces are pushing their way into the system and practical business sense dictates that change must take place if business is to survive. Many Japanese firms can no longer ignore global competition and have little choice but to go along with global standards. They have to shift from the old management system to one compatible with global practices.¹⁴⁴ Keidanren argued that the economy of Japan was in such a grave situation and the dislocations coming out of the economic crisis were pressuring business, 'indeed, the economy itself—to drastically restructure and rationalise their operations'.¹⁴⁵

4.128 A situation has developed in Japan in which pure business considerations now take precedence over the old-style emphasis on close human relationships and attachment to traditions and habits that are far removed from the values of today's corporate world.¹⁴⁶ The growing urgency to make adjustments to changed circumstances has begun to replace the complacency, the lack of commitment and even the natural inclination to stay with the familiar. Mr Chester Dawson noted:

For years, board rooms in Tokyo delayed making painful choices in the hope that a strong tide of economic recovery would lift the country. But after nearly a decade in the doldrums, the prospects for a return to the boom

141 Terrence White, Australia-Japan Foundation, *Committee Hansard*, 19 February 1999, pp. 48–9; DFAT, submission no. 32, p. 26.

142 Yuichi Shionya, 'Japan's Grand Reforms: From an Economic, Social and Political Perspective', Transcript of a speech delivered on 12 May 1997, at Asia Foundation and Public Policy Institute of California, http://www.infojapan.org/j_info/japan/socsec/sionoya.html.

143 Noguchi Yukio, 'The Persistence of the 1940 Setup', *Japan Echo*, vol. 24, Special issue, 1997.

144 See Dr Keiko Morita, *Committee Hansard*, 15 April 1999, p. 310.

145 Keidanren, 'Keidanren Urges the Government to Resolutely Carry out Sweeping Regulatory Reforms', 19 October 1999, <http://www.keidanren.or.jp/english/policy/pol1107.html> (5 November 1999).

146 Jiro Ushio, Chairman's Address for the 1998 Annual Meeting, Keizai Doyukai, 22 April 1998.

years of the 1980s remain dim. Now, pressure for reform may finally be nearing critical mass after years of losses and amid increased competition resulting from deregulation.¹⁴⁷

4.129 The recession has given added incentive for businesses in Japan denied opportunities for growth because of existing regulations to lobby for reform. These enterprises can see the gains to be made from a market more open to international trade and investment. They can see the need to become better managed and are jettisoning traditional management practices. Business leaders frustrated at being beaten in international competition can no longer wear unnecessarily high costs born of domestic inefficiencies. Japan's corporate giants are demanding reform. Moreover, they are no longer waiting for government and the bureaucracy to make the difficult changes. They see the urgent need to adjust and are proceeding to do so.¹⁴⁸

4.130 Put simply, Japanese companies, facing globalization, rapid advances in information technology, and other changes in the economic environment amidst continuing domestic economic stagnation, are compelled to radically restructure their operations.¹⁴⁹ Managers are taking a long hard look at their business and some are now taking the lead. Nissan's announcement of its ambitious corporate remodelling plan in October 1999, indicated that corporate Japan was finally accepting that it had no other alternative—to survive it must restructure. The chief operating officer for Nissan admitted that the restructuring plan, which involved the establishment of a performance-based career advancement program and the closure of three assembly plants and two powertrains operations, was 'born of desperation'.¹⁵⁰

4.131 The banking sector also demonstrates how business is embracing reform in its struggle to survive in the market place. Financial reform, which facilitated a series of bank mergers in 1999, has begun to redefine banking in Japan. It has allowed the entry of foreign companies into Japan and intensified competition.¹⁵¹ A number of major

147 Chester Dawson, 'Brave New World', *Far Eastern Economic Review*, 28 October 1999, http://www.feer.com/9910_28/p76economiesb.html (18 November 1999).

148 For example see Yuichi Shionoya, 'Japan's Grand Reforms: From an Economic, Social and Political Perspective', Transcript of a speech delivered on 12 May 1997 at Asia Foundation and Public Policy Institute of California, http://www.infojapan.org_info/japan/socsec/sionoya.html (29 October 1999); Michael Hirsh and E. Keith Henry, 'The Unraveling of Japan Inc.', *Foreign Affairs*, March/April 1997, pp. 12–13.

149 Yoshio Ichiryu and Yuji Hosoya, MITI/RI Discussion Paper no. 98-DOF-29, 'New Developments in Economic Policy: Complementarity between Government and the Market Place', September 1998.

150 News Release, 'Nissan unveils Revival Plan', 18 October 1999, Tokyo, http://global.nissan.co.jp/Japan/NEWS/199991018_0e.html (18 November 1999). See articles following the decision by Nissan to shut a number of plants, *Asia Time*, 20 October, 1, 5 and 19 November 1999.

151 In September 1999, Ripplewood Holdings acquired the Long Term Credit Bank of Japan (LTCB) which had been placed under temporary nationalization in October 1998. The LTCB had retained Goldman Sachs as its financial adviser to facilitate its sale. Memorandum of Understanding on Acquisition of LTCB, 28 September 1999, <http://www.ltc.co.jp/docsdir/en/news/press0928.html> (19 November 1999). See also Professor Morris-Suzuki, *Committee Hansard*, 24 May 1999, p. 604; and Professor Peter Drysdale, *Committee Hansard*, 23 August 1999, p. 765.

banks have responded to the changing climate by restructuring. In May 1999, the Mitsui Trust & Banking Co. Ltd and the Chuo Trust & Banking Co, Ltd announced a proposed merger. The board of directors of both banks acknowledged that in the context of the ‘Big Bang’ financial reforms, Japan’s economic environment and its financial industry has been changing rapidly. They believed that their organisation must build a solid management foundation that could withstand shifts in the environment.¹⁵²

4.132 In August 1999, Dai-Ichi Kangyo Bank, Fuji Bank and the Industrial Bank of Japan announced an alliance that would form the world’s biggest bank. As part of the restructure, the new group announced its intention to downsize its work force by 6,000 within five years and to commit itself to create and develop a fair human resource management system in which individuals would be evaluated on their level of expertise and job performance. They stated that the group would invest in strategically important areas such as information technology development.¹⁵³ In October 1999, the Sumitomo Bank and Sakura Bank announced plans to merge. This quest for greater efficiency and improved competitiveness in the banking sector is forcing massive restructuring.¹⁵⁴

4.133 Moreover, the entry of foreign companies offering wider choices and better services is pushing change. In February 1998, Merrill Lynch & Co. Inc., announced its intention to establish a nationwide network of private client offices in Japan. The company began to hire and train approximately 2,000 people, most of whom worked for the former Yamaichi Securities Company. The president of Merrill Lynch Japan Securities announced that ‘we look forward to helping fulfil the objectives of the Big Bang financial reforms in Japan which include increased competition and greater choice for investors’.¹⁵⁵

4.134 The recessionary environment has also given consumers a renewed concern for value for money and they are now less inclined instinctively to prefer Japanese products before foreign products. The economic downturn has encouraged heavy discounting by retailers and introduced consumers to lower priced, good quality foreign products. This has added to the competitive pressures already at work in the domestic market.¹⁵⁶

152 The Chuo Trust & Banking Co. Ltd, Announcement of Merger, 24 May 1999, <http://www.chuotrust.co.jp/eng/may/2499a.html> (18 November 1999).

153 The Dai-Ichi Kangyo Bank, Limited (“DKB”), the Fuji Bank, Limited (“Fuji”) and the Industrial Bank of Japan, Limited (“IBJ”) to get consolidated to form a new financial services group (“the New Group”) News Release, <http://www.fujibank.co.jp/pub/news/news-e/news-e8-20.html> (18 November 1999).

154 Christopher Pokarier, submission no. 10, p. 6.

155 In May 1998, the Ministry of Finance approved a securities business licence for Merrill Lynch Japan Securities, a wholly owned subsidiary of Merrill Lynch, the company’s new private client business serving individual investors in Japan. Merrill Lynch press release, 12 February and 26 May 1998, http://www.ml.com/woml/press_release (21 January 2000).

156 Austrade, submission no. 35, p. 7.

4.135 Mr Michael Hirsh, Business Editor for Newsweek, and Mr E. Keith Henry from the Massachusetts Institute of Technology's Japan Program, argued that the cutthroat competition has undermined the old cartelized relationship between manufacturers, wholesalers and retailers—the 'price-it-high-at-home-and-dump-it-abroad system', at the heart of Japan Inc., no longer functions. Consumers now refuse to pay high prices at home to subsidise inefficient producers.¹⁵⁷

4.136 The need to survive in an increasing competitive world has forced change and there appears to be no going back. International business organisations involved in trade and investment, particularly those in financial and capital markets, have no choice but to have their operations conform to international standards. The practice adopted by the leading businesses and institutions in spearheading international competition will inevitably affect domestic practices.¹⁵⁸

Practical politics—surviving at the polls

4.137 Thirdly, there is the political imperative for change. Indeed, as the voice for reform grows louder and more strident, the government's response is likely to become more positive. Despite the leadership's lack of aggression and urgency in tackling economic restructuring, reform is nevertheless under way, although in some respects, especially on the economic front, it has not been as far-reaching nor as timely as some critics believe is required.

4.138 The decision to deregulate rests inevitably with the government. Although political parties may represent special interest groups, they also have to take account of matters of growing importance to the broader community and particularly to issues around which a national consensus is building. As the call for reform gathers force in Japan, political leaders see benefits in presenting themselves as credible agents of change. In a democratic country, politicians who ignore these general trends in public opinion, who do not heed the growing voice for reform over special interest groups, do so at their own risk.¹⁵⁹

4.139 As Mr Pokarier pointed out, 'Regulatory reform, as in all democracies with well-organised interest groups where the constituencies for reform are stronger than those resisting, has proceeded apace.'¹⁶⁰ It would seem that in Japan the time has arrived when the push for reform is gaining over the pull against it. Although there are the inevitable points of political resistance from industries likely to suffer because of change, the emerging support for economic reform will eat into such resistance.

157 Michael Hirsh and E. Keith Henry, 'The Unravelling of Japan Inc.', *Foreign Affairs*, vol. 76, no. 2, March/April 1997, p.13.

158 Keiko Morita, *Committee Hansard*, 15 April 1999, p. 310.

159 Dr Aurelia George Mulgan, submission no. 20, p. 24. See also Aurelia George Mulgan, 'The Politics of Deregulation and Japanese Agriculture, in T.J. Pemwel et al. Also, *The Politics of Economic Reform in Japan: Collected Papers*, Pacific Economic Papers, No. 270, August 1997.

160 Christopher Pokarier, *Committee Hansard*, 16 April 1999, p. 429.

4.140 According to Dr George Mulgan, government and party leaders can be expected to take a more reformist stance as business and the public grow increasingly strident in their demands.¹⁶¹ Indeed, the reforms introduced to rescue and to restructure the banking system stemmed from overwhelming public and business pressure.

4.141 Many commentators have noted the tendency for government to respond only when confronted with immediate problems. For example, the failure of major financial institutions in November 1997 provided a jolt that prompted the administration to take decisive action to resolve problems in the banking sector and gave the Big Bang reforms a sharp nudge. Mr Arthur Alexander observed that these financial failures introduced an element into economic policymaking in Japan that had been absent until then—utter fear. He stated:

Political, bureaucratic and popular reactions led to strategies to inject public funds into rescuing depositors and recapitalizing banks. The new policies also resulted in the closure of several insolvent institutions, albeit with great reluctance on the part of bureaucrats and mainstream politicians alike.¹⁶²

4.142 Clearly, the Japanese Government was forced to deal with the bad debt issue—prevarication was no longer an option.¹⁶³ Throughout 1999, the Financial Revitalization Commission, on finding a number of banks in financial difficulties, directed that their operations and the management of their assets be placed under financial reorganisation administrators. Although highlighting the seriousness of problems in the banking sector, the actions of the Commission nevertheless sent a loud and unmistakable statement of the government's determination to clean up the banking mess.¹⁶⁴

4.143 To summarise Japan's predicament, Mr Ken Curtis, Managing Director, Deutsche Bank Group, explained:

...Japan is now squeezed in the vice of demographics; a very quickly ageing Japan; debt, deflation, the enormously disruptive pressure that comes from the new technologies, global competition. And so the whole thing now is

161 Dr Aurelia George Mulgan, submission no. 20, p. 25.

162 Arthur J. Alexander, 'On-the-Ground Impressions of Japan's Economic Problems', *Japan Economic Institute Report*, no. 8A, 26 February 1999, p. 9. The most recent example of the Japanese Government bowing to public criticism involved the government's decision not to bail out department store giant Sogo by waiving loan claims. See *Daily Yomiuri Online*, 14 July 2000 and *AsiaNow Time*, 31 July 2000, <http://www.cnn.com/ASIANOW/time/magazine/2000/0731/japan.seiyo.html> (26 July 2000).

163 For example see Financial Reconstruction Commission, 'Basic Operating Policies for the Financial Reconstruction Commission', (Summary, Provisional translation) 20 January 1999.

164 Some examples of banks being placed under administrators are: Kokumin Bank Ltd in April; Tokyo Sowa Bank, Ltd in June; the Namihaya Bank Ltd, in August; and the Niigata Chuo Bank, Ltd in October 1999.

pushing and this country is in a massive pressure cooker, and that's what's forcing the change.¹⁶⁵

4.144 In brief, the process of deregulation is likely to gather force because of the continuing recession and because of increasing pressure both from within Japan and abroad for more radical change. Competition in the market place is driving reform. The Japanese people are beginning to feel more confident about putting their money into overseas financial institutions, and are demanding better service from their bankers and brokers.¹⁶⁶ Deregulation and increased competition have certainly undermined the highly regulated system.

4.145 Nonetheless, the tension between the different vested groups within Japan will continue to tug the government in different directions. The Economist Intelligence Unit observed in early 2000 that with the next lower house election drawing closer, the government had started to step back from economic reforms, fearful of their impact on its key supporters.¹⁶⁷

4.146 The bureaucracy, government and business as individual entities and together as the dominant power structure in Japan are finding the pressure to reform compelling. The links between them have for a long time controlled the ability of foreign firms to do business in Japan but their influence has been weakened.¹⁶⁸

4.147 Some fear, however, that rather than an overall opening of markets, regulatory reform in Japan will lead to 'selective market openings based on a combination of strategic concerns, the political clout of certain factions of business, market factors, and pressure from foreign governments'. As Mr Mark Tilton argued, 'managed deregulation will simply substitute for managed markets'.¹⁶⁹ Undoubtedly, reform in Japan will follow a course determined by a range of factors, including the influence of factional interests and economic imperatives. Nonetheless, the push for reform is gathering strength.

The momentum of change

4.148 The forces resisting change in Japan are lined up against a powerful array of counter forces that are gradually but surely gaining ground. Change which requires the application of concerted pressure because of the strength and resistance of domestic

165 Mr Ken Curtis, Managing Director, Deutsche Bank Group, transcript, 'Lateline', 2 November 1999.

166 Yasuo Kanzaki, Chairman, Nikko Research Center Ltd, 'Deregulation in Japan: Big Bang or Big Whimper?', a talk delivered at the Woodrow Wilson International Center for Scholars, Smithsonian Institution, Washington, Japan Information Access Project, 7 March 1997.

167 The Economic Intelligence Unit, *Country Report*, Japan, 1st quarter 2000. This report cited the following examples of the government's prevarication on reform—the postponement of the imposition of consolidated accounting and the backtracking in the area of deposit insurance, p. 19.

168 For example see, Austrade, submission no. 35, p. 10.

169 Mark Tilton, 'Japanese Deregulation: What you Should Know', Japan Information Access Project, <http://www.nmjc.org/jiap/deregulate/papers/deregcon/tilton.html> (15 June 1999).

vested interests in Japan is not only occurring but is gaining momentum. In many cases, the course is fixed. The banking sector reform provides an example of where reform and market imperatives have joined forces to reshape the financial landscape in Japan.

4.149 Having introduced reform, the process is difficult to reverse. Thus, although reform has been implemented piecemeal over the last ten years, it has set in train a process that is gathering force and appears irreversible. Put simply, reform will be difficult to pull back as it gathers momentum. Peter Hartcher pointed out that where the government has succeeded in clawing back resistance from vested interests and made some inroads into the regulatory web choking Japanese economic activity, there has been an upsurge in activity. The relaxation of regulations governing telecommunications and retailing saw growth in the freer environment. Even marginal relaxation of regulations has produced major changes.¹⁷⁰ Minister Taichi Sakaiya recently noted:

The major reforms in the financial system have shaken the very foundation of the vertical 'keiretsu' corporate groupings centered around large financial institutions, and this trend will only intensify from next year as the integration and mergers of the nation's principal financial institutions that have already been announced are implemented.

At the same time, the corporate 'keiretsu' affiliations linking major manufacturers and general contractors with their subcontractors are rapidly dissipating. Having been separated from their financial 'keiretsu' affiliates, manufacturers and general contractors are now facing harsh price competition, forcing them to procure parts more quickly and at lower prices.¹⁷¹

4.150 Moreover, the low economic growth rate has been an important stimulus for change. Increased competition in Japan has transformed the market place. Consumers are beginning to see the benefits to be gained from lower prices and wider choices and have become far more discriminating.

4.151 Japan has been walking on the edge of change for some time. It seems as though it now, however reluctantly, has stepped onto the road toward a more market-based and competitive society. How far it travels along this route and at what pace it chooses to proceed will have a bearing on Australia's relationship with Japan. Australia and Japan have been partners for many years and Australia will have to take close note of the changes taking place in Japan so that it can support Japan through its transition and ensure that their partnership will continue to develop and grow.

170 Peter Hartcher, *Committee Hansard*, 15 April 1999, p. 332.

171 Taichi Sakaiya, Minister of State, Economic Planning Agency, Government of Japan. 'The Present and Future of the Japanese Economy', Speech at Yale University, Connecticut, US, May 2000, <http://www.epa.go.jp/2000/b/0505b-daijinkouen-e.html> (5 July 2000).

Recommendation

The Committee recommends that the Australian Government take this opportunity to reaffirm its long-term and sincere commitment to the Australia-Japan partnership.

CHAPTER 5

AUSTRALIA AND JAPAN—A TRADING TRADITION

5.1 Despite difficulties, the Australia-Japan relationship has matured and deepened over many decades. In this chapter, the Committee traces the development of Australia's trading relationship with Japan. It looks at the first hesitant and cautious steps taken by Japan to establish trading links with the Australian colonies in the later half of the 19th century; the slow evolution of trade between the two countries in the first decades of the 1900s; the rift in relations during the 1930s; and the problems in resuming trade after the war. It examines the significant qualitative change that has taken place in Australia's trading relationship with Japan especially after the two countries signed a commerce agreement in 1957 and with the emergence of Japan as a major industrial nation during the 1960s and 1970s.

A cautious beginning

5.2 Australia and Japan have a long history of trade with roots going back to the second half of the 19th century. Coal was the first recorded traded commodity from Australia to Japan in 1865.¹ In the latter half of the 1870s, two Japanese commissioners, Mr Masato Hashimoto and Mr Haruo Sakata, visited intercolonial exhibitions in Melbourne and in Sydney intended to showcase overseas products. They took note of the relative proximity of Australia to Japan and reported that prospects for trade between the two countries appeared very promising. To encourage commercial activity between Australia and Japan, Mr Sakata suggested that the Japanese Government take steps to improve the shipping services between the two countries and appoint consuls to the colonies. During the 1890s, the Japanese Government showed its genuine interest in establishing trading links with the colonies by following up on Sakata's suggestion. It subsidised the Nihon Yusen Kaisha's Australian shipping line and sent career consuls to Townsville and Sydney.² BHP and Japan laid the foundations of a partnership when the first BHP director toured Japan in 1888.³

5.3 Between 1887 and 1906 Australian exports to Japan, although only a tiny fraction of total Australian exports, rose from 0.03% to 1.74%. On a similar small scale, Japan accounted for 0.11% of Australia's total imports in the 1887–91 period.

1 Alan Rix, *Coming to Terms: the politics of Australia's trade with Japan 1945–57*, Allen & Unwin, Sydney, 1986, p. 20; and Peter Robinson, *Towards a Total Partnership: a View of Australian-Japanese Trade Relations*, 1977, p. 13.

2 Neville Meaney, *Towards a new Vision: Australia & Japan, Through 100 Years*, Kangaroo Press, Sydney, 1999, p. 56.

3 Jim Lewis, President, BHP Non Ferrous and Industrial Materials, The Broken Hill Propriety Company Ltd, 'Australian minerals sector partnership with Japan a productive past—a challenging future', <http://www.ausimm.com.au/branches/canbl.html> (7 December 1999).

This share rose to 0.95% in 1906. At this time, Australia imported mainly apparel and textiles, sulphur, rice, oils and furniture from Japan while Australia supplied Japan with gold, wool, lead and flour.⁴

5.4 From these tentative beginnings, and by degrees, Japan and Australia gradually built up a trading relationship around a sound and clear comparative advantage—Australia the supplier of industrial raw materials and food and Japan the producer of manufactured goods.⁵

5.5 By 1920, trade between the two countries had increased incrementally with 4.8% of all Australian exports going to Japan and in return 4.3% of all Australian imports coming from Japan. The composition of trade between the two countries was also broadening. Australia was importing a greater variety of goods from Japan including apparel, piece goods and textiles, wood and wicker, chinaware, glass and glassware, and fancy goods. Similarly, Australian exports to Japan had expanded but wool, flour and wheat made up the bulk of exports which also included tallow, pig iron, and copper ingots.⁶ During the 1920s, Australian exports to Japan rose marginally reaching 8.78% of total Australian exports in 1927–28 before falling to 5.2% in 1929–30. Japanese imports into Australia remained steady at around 3% of Australia's total imports.⁷

5.6 Despite cultural differences and Australia's strong political and commercial ties to the United Kingdom, the trading relationship between Australia and Japan was amicable. It was not, however, without its misunderstandings and difficulties.

5.7 After the Australian colonies united as a Federation in 1901, protectionists took charge of the trade policy agenda. Tariffs were increased markedly in 1907, 1921, 1926 and in the 1930s. Trade with Japan suffered mainly because of Australia's discriminatory licensing and tariff system, which gave special preference to imports from Britain and her dominions. Moreover, this protectionist and discriminatory trade policy was set against an uneasy background of Australian anxieties about Japan's expansionist designs in the Pacific region. Despite both the practical and cultural obstacles, trade between the two countries gradually, though at times faltering, developed through the first three decades of the century.

1930s—trade disputes

5.8 During the 1930s, however, commercial relations between Japan and Australia soured as Australia took steps to further protect and consolidate its trading

4 *Official Year Book of the Commonwealth of Australia*, No.1—1908, Melbourne, 1908, pp. 501, 504, 506 and 508.

5 Alan Rix, *Coming to Terms: the politics of Australia's trade with Japan 1945–57*, Allen & Unwin, Sydney, 1986, p. 11.

6 *Official Year Book of the Commonwealth of Australia*, 1901–1907, No. 1—1908, pp. 503, 508, and 510 and No. 14—1921, pp. 500, 503, 508, 510.

7 *Official Year Book of the Commonwealth of Australia*, No. 24—1931, Melbourne, pp. 118, 120.

interests with the United Kingdom. At this time, the Australian business community relied heavily on British investment for funds and Australian agricultural producers looked to Britain as a friendly, reliable and most valued market. The Ottawa Agreement of 1932 upheld the principle of preferential trade and confirmed Britain as Australia's most important customer and central to its trading interests. Countries such as Japan, while important to Australia, had to take second place behind the trading concerns of the United Kingdom.

5.9 In May 1936, the Australian Government further entrenched the principle of preferential trade with the implementation of a new Australian trade policy—a 'trade diversion policy'. It was intended to increase exports of primary produce, expand secondary industry and increase rural and industrial employment. Certain imports would be restricted with the intention of encouraging their manufacture in Australia while other imports would be diverted from their current source to countries that were valued customers of Australia, in the hope that their economic ties would become even stronger.⁸ In effect, tariff rates were to be raised substantially and a special licensing system introduced which would discriminate against imports from countries such as Japan and the United States while favouring British imports.

5.10 Upset by this decision, the Japanese, who had run a trade deficit with Australia for many years, retaliated by pulling back from the Australian market and seeking alternative sources for products, such as wool and wheat.⁹ In June 1936, it promulgated an ordinance that directed that any goods produced or manufactured by a country, namely Australia, applying unreasonable restrictive measures to the importation of goods produced or manufactured in Japan should not be imported into Japan for one year without special permission. It also provided for the imposition of an import duty of 50% ad valorem to be applied to goods such as beef, butter and tallow from such countries. The dispute brewed for a while until it was finally resolved in an uneasy settlement at the close of 1936.¹⁰

5.11 This disagreement undermined a relationship already under great strain from the mounting fears of conflict in the Pacific and Australia's preoccupation with its own security. Many in Australia feared that Japan was actively pursuing a 'southward advance policy' and that Japanese capital for economic development was a feature of that design. They regarded Japan's economic penetration into countries in the region as a manifestation of its drive south plan and feared that Japan would attempt to secure a foothold in Australia. Moreover, they believed that the Japanese in seeking to obtain an economic presence in another country were not necessarily working in the best interests of the host country and that Japan was prepared to invest even in

8 *Official Year Book of the Commonwealth of Australia*, No. 30—1937, Melbourne, 1908, p. 493.

9 In 1934–35 Japan was importing Australian products valued at £Stg9,657 but exporting only £Stg4,625 worth of goods to Australia. In 1935–36 the deficit had increased—Japan was importing products from Australia valued at £Stg14,101 and in return exporting products valued at only £Stg4,970, *Official Year Book of the Commonwealth of Australia*, No. 30—1937, p. 507.

10 *ibid.*, p. 494.

unpromising ventures to consolidate its hold on foreign soil. Thus, the activities of a Japanese mining company keenly committed to exploiting iron ore deposits at Yampi Sound fuelled Australian misgivings about the threat from the north and reignited old anxieties about Japan's territorial intentions.¹¹

5.12 The Australian Government was disturbed by the proposed mining project on its north-west shores and the public attention it was attracting in Australia. When it finally decided to intervene by banning the export of iron ore, plans were well advanced and the Japanese company had already spent considerable money on developing this large project. Although the Australian Government was unhappy about the establishment of this Japanese enterprise in Australia, such a view was not part of the formal explanation for prohibiting the export of iron ore from Australia. In explaining its action, and based on a recent geological study, the Australian Government argued that the country's available resources were only sufficient to serve the next generation.¹²

5.13 Not satisfied with this explanation, the Japanese were indignant at Australia's actions, pointing out that their need for iron ore was not the only motive for investing in mining and that they were most anxious to foster cordial relations between the two nations. They expressed regret at the 'considerable lack of understanding of Japan by the Australian people'.¹³

5.14 The bitter trade dispute in 1936, together with the Australian iron ore embargo, left a disagreeable aftertaste in commercial relations and trade between the two countries did not fully recover for many years. In 1936–37, Australian exports to Japan more than halved and continued to fall. Japanese imports of Australian wool and wheat declined noticeably in the late 1930s and ceased altogether for a while

11 For example see: Mr Longfield Lloyd, Trade Commissioner in Japan to Mr J. F. Murphy, Secretary of Department of Commerce, 6 October 1937, *Documents on Australian Foreign Policy 1937–38*, R.G.Neale (ed.), AGPS, Canberra, 1975, pp.234–5.

12 For example see: Mr F. G. Shedden, Secretary of Department of Defence, to LT Col W. R. Hodgson, Secretary of Department of External Affairs, 6 December 1937, *Documents on Australian Foreign Policy 1937–38*, R. G. Neale (ed.), AGPS, Canberra, 1975, pp. 237–9 and Memorandum by Lt Col W. R. Hodgson, Secretary of Department of External Affairs, for Mr R. G. Casey, Minister in Charge of Development, *Documents on Australian Foreign Policy 1937–38*, R.G.Neale (ed.), AGPS, Canberra, 1975, pp.240–2.

13 Memorandum by Lt Col W.R. Hodgson, Secretary of Department of External Affairs for Mr R.G. Casey, Minister in Charge of Development, 13 December 1937; Mr Torao Wakamatsu, Japanese Consul-General in Sydney, to Mr J. A. Lyons, Prime Minister, 5 April 1938; Mr Torao Wakamatsu, Japanese Consul-General in Sydney, to Mr J. A. Lyons, Prime Minister, Sydney, 24 May 1938, *Documents on Australian Foreign Policy 1937–38*, R. G. Neale (ed.) AGPS, Canberra, 1975, pp. 240–242, 312–315, 356–357. Neville Meaney, *Towards a New Vision: Australia & Japan, Through 100 Years*, Kangaroo Press, Sydney, 1999, pp. 78–9.

5.15 during the course of the Pacific war.¹⁴ The ban on the export of iron ore was not lifted until the 1960s.¹⁵

Toward the Australia-Japan Agreement on Commerce

Immediate post-war—re-establishing trade links with Japan

5.16 Immediately after the war, Australia's commercial relations with Japan were restricted solely to trading between the Australian Government and the Supreme Commander for the Allied Powers in Japan (SCAP). Transactions were confined to the sale of wool and the purchase of raw silk, textiles and yarns. By mid-1947, although holding firm to its declared policy that the resumption of private trade was a matter to be determined at a Peace Conference, the Australian Government could see that other countries were making plans to re-establish trade links with Japan. The United States and the United Kingdom, in particular, were well advanced in preparing the groundwork for the resumption of trade.

5.17 Despite strong anti-Japanese feeling in Australia and resistance to the resumption of trade with Japan, some sections of Australian business and government were worried that Australia would lose out if it did not keep up with other countries in building commercial ties with Japan. In May 1947, the Ministers for External Affairs; Trade and Customs; and Commerce and Agriculture submitted to cabinet:

Notwithstanding the Australian policy that the resumption of private trade with Japan is a matter for decision by the Peace Conference it seems that, particularly in view of the action already taken by other countries, Australia should make detailed preparations for the resumption of trade at the earliest possible moment so as to ensure that Australian businessmen will be placed on an equal footing with those of other nations at whatever date it is actually resumed.¹⁶

5.18 Significantly, at this early stage, Australia was already asserting its claim as 'the only country in eastern Pacific area with a substantial interest in the supply of both raw materials and manufactured goods to the Orient'. Further, that 'Australia looks to substantial development of two-way postwar trade with Japan and may be expected, from her geographical position, to look to Japan as a natural market and

14 Exports from Australia to Japan fell from 14.19% in 1935–36 to 6.54% in 1936–37; 4.16% in 1937–38 and 3.97% in 1938–39. Imports fell from Japan though not as significantly. In 1935–36 Australia imported 6.09% of its total imports from Japan. This fell to 4.52% in 1936–37; 4.90% in 1937–38 and 4.22% in 1938–39. *Official Year Book of the Commonwealth of Australia*, no. 34—1941, pp. 663, 665.

15 Sandra Tweedie, *Trading Partners Australia and Asia 1970–1993*, UNSW Press, Sydney, 1994, pp. 143–6; Peter Robinson, *Towards a Total Partnership: a View of Australian-Japanese Trade Relations*, 1977, p. 21.

16 Cabinet Submission by Evatt, Courtice and Pollard, Agendum 1343, 26 May 1947, in *Australia and the Postwar World, Documents 1947*, Department of Foreign Affairs, 1995, pp. 674–675.

supply centre'.¹⁷ This notion of 'natural market' would develop into a dominant theme that would form the basis of Australia-Japan commercial relations for years to come.

5.19 On 15 August 1947, Japan was formally opened to private trade but commercial activity between Australia and Japan was slow to revive. The Sterling Payments Agreement in 1947 and 1948, which settled the mode of payment, overcame one of the main practical obstacles to trade, and set trade between the two countries on a firm footing. From these beginnings, a trading pattern based on mutual advantage evolved. Australia, predominantly a primary producer, exchanged agricultural commodities for manufactured goods produced by Japan. Wool exports, which increased sharply between 1948 and 1950, opened the way to trade with Japan and became Australia's principal export to that country.

1950s—trade agreement

5.20 Indeed, throughout the 1950s, Australia's economy rode happily on the sheep's back but it relied heavily on Britain as its primary export market. The United Kingdom, far and away, was Australia's main export market and most important trading partner. In 1950–51 Japan ranked as Australia's fourth largest export market with exports valued at nearly £61.5 million; in 1954–55 it was our third largest market with exports valued at £58.6 million and in 1955–56 it was second to the United Kingdom in importance taking Australian exports valued at £86.5 million.¹⁸

5.21 Clearly, Australia looked to the United Kingdom as its major export market but Japan could see that it held a position of growing significance to Australia as a trading partner and sought to establish a better understanding of their trading relationship. In 1954–55, nearly 8% of Australia's total exports went to Japan; by 1956–57 this had almost doubled. Over the same period, the United Kingdom's share of Australia's export market had dropped from 37.5% to 28.4%.¹⁹

5.22 Japan was also aware of its widening deficit in trade with Australia. In 1950–51 the trade deficit amounted to nearly £46 million. In 1954–55, it stood at just over £40 million. A year later this had jumped to almost £64 million and in 1956–57 the Japanese trade deficit with Australia had reached over £125 million.²⁰ Moreover, Australia's tardiness in responding to Japanese initiatives to discuss Australian import

17 Department of External Affairs to Embassy in Washington, Cablegram 628, Canberra, 2 June 1947, *Australia and the Postwar World, Documents 1947*, Department of Foreign Affairs, 1995, p. 677.

18 Minute from Crawford to McEwen, Canberra, 1 June 1953, *The Australia-Japan Agreement of Commerce 1957*, Department of Foreign Affairs, 1997, p. 47. See *Official Year Book of the Commonwealth of Australia*, No. 44—1958, p. 345.

19 *Official Year Book of the Commonwealth of Australia*, No. 44—1958, p. 346.

20 *Official Year Book of the Commonwealth of Australia*, No. 39—1953, p. 482; no. 44—1958, p. 354.

restrictions on Japanese products further annoyed the Japanese and strained the trading relationship.²¹

5.23 At this time, Australia imposed import licensing measures on Japanese imports as well as applying the General Tariff (the highest tariff rate) to Japanese goods.²² On a number of occasions during 1953, Japan approached the Australian Government and expressed its desire to see such restrictions relaxed. It made clear its growing impatience with the trading regime between the two countries by seeking business elsewhere. Whereas Japan had been purchasing up to 90% of its wool from Australia, it reduced this percentage in 1954 to 50%.²³

5.24 The following table provides Japanese trade figures from 1949 to 1953. These statistics show the extent of Japan's trade deficit with Australia.

Table 5.1—Japanese trade figures with Australia 1949 to 1953.			
Note figures are given in \$US			
	Japanese exports to Australia	Japanese imports from Australia	Trade deficit
	\$US million	\$US million	\$US million
1949	509.7	904.8	395.1
1950	820.1	974.3	154.2
1951	1354.5	1995.0	640.5
1952	1272.9	2028.0	755.1
1953 (10 months)	1029.1	1962.8	933.7 ²⁴

5.25 Japan persisted with its requests to the Australian Government for trade talks and, finally, in May 1956, Australia decided that it would enter into trade negotiations

21 Cablegram from Walker to Watt, 9 June 1953, *The Australia-Japan Agreement on Commerce 1957*, Department of Foreign Affairs, 1997, p. 51.

22 Submission 614 to Cabinet by McLeay, 30 January 1954, *The Australia-Japan Agreement on Commerce 1957*, Department of Foreign Affairs, 1997, p. 87.

23 Appendix A, Submission 30 to Cabinet by Casey, Canberra, 28 July 1954, *The Australia-Japan Agreement on Commerce 1957*, Department of Foreign Affairs, 1997, p. 118.

24 Appendix A, Submission no. 30 to Cabinet by Casey, 28 July 1954, *The Australia-Japan Agreement on Commerce 1957*, Department of Foreign Affairs, 1997, p. 115.

with Japan.²⁵ After lengthy consultations, an agreement was signed in July 1957.²⁶ It provided that Australian exports would receive equal tariff treatment along with other foreign suppliers to Japan and, in return, Japan would be granted the same tariff and import licensing treatment accorded to all foreign countries importing goods into Australia. This meant that Australian duties charged on certain Japanese goods would no longer be higher than the duties charged on the same goods from other foreign countries. Put simply, Japan was no longer to be singled out 'for specially restrictive measures directed against Japanese goods alone'.²⁷

5.26 This agreement was a major step forward in establishing a cooperative framework within which both countries would conduct trade. It marked a milestone in Australia's trading relationship with Japan that was growing year-by-year in importance, diversification and complexity. In a memorandum to the Department of External Affairs, T. W. Eckersley in Tokyo noted:

The granting of most-favoured-nation treatment to Japan has, of course, political and psychological significance not measurable, as in trade, in terms of money. The removal of discrimination is the removal of a thorn which has troubled the Japanese almost since the time when they first came into contact with the West.²⁸

5.27 Australia, nonetheless, sought to assure the United Kingdom, its traditional and most significant trading partner, that it would continue to maintain strong and close trading ties. In 1957, the Prime Minister wrote to the Secretary of State for Commonwealth Relations:

I might add that while the agreement [with Japan] will remove import licensing discriminations which are being maintained now against Japan alone, and will put her goods on the same tariff footing on entry into Australia as the goods of almost all foreign countries, there is of course no doubt that United Kingdom traders will continue to enjoy the guaranteed margins of preference.²⁹

25 Cabinet Decision 203, Canberra, 21 May 1956, *The Australia-Japan Agreement on Commerce 1957*, Department of Foreign Affairs, 1997, p. 241.

26 See Appendix 3.

27 Statement by McEwen, 6 July 1957, *The Australia-Japan Agreement on Commerce 1957*, Department of Foreign Affairs, 1997, pp. 449–455.

28 Memorandum from Eckersley to Department of External Affairs, Tokyo, 10 July 1957, *The Australia-Japan Agreement on Commerce 1957*, Department of Foreign Affairs, 1997, p. 455.

29 Letter from Menzies to Home [Lord Home, Secretary of State for Commonwealth Relations], 4 July 1957, *The Australia-Japan Agreement on Commerce 1957*, Department of Foreign Affairs, 1997, p. 430.

5.28 But old loyalties were giving way to practical business, and Britain was increasingly being drawn into the European trading community. As Britain looked to Europe to establish closer trading links, Australia turned to East Asia. In 1954–55, the United Kingdom took 37.5% of all Australian exports. This fell to 25.7% in 1959–60.

5.29 As the United Kingdom's dominance as Australia's trading partner began to wane, Japan's importance to Australia grew. Japan accounted for 7.7% of all Australian exports in the middle of the 1950s which, within five years, had climbed to 14.5%.³⁰ In 1959–60, Japan replaced the United Kingdom as Australia's principal market for wool.

5.30 The following table provides information on the value of Australian exports to its major export markets in the 1950s. It traces the increasing importance of Japan to Australia as a trading partner in this decade.

Table 5.2—Value of Australian exports to its major export markets in the 1950s

	1954–55		1955–56		1956–57	
	£m	rank	£m	rank	£m	rank
1. United Kingdom	285.4	(1)	257.3	(1)	277.5	(1)
2. Japan	58.6	(3)	86.5	(2)	139.0	(2)
3. France	64.1	(2)	67.3	(3)	92.0	(3)
4. United States	52.4	(4)	55.0	(4)	66.0	(4)
5. Italy	35.9	(6)	34.6	(7)	53.0	(5)
6. New Zealand	37.8	(5)	40.9	(5)	50.9	(6)
7. Germany	31.8	(7)	36.4	(6)	46.9	(7) ³¹

5.31 Although Australian exports to Japan increased substantially during the 1950s, imports from Japan remained relatively stable at around 2% to 3% of total imports and reached 3.7% in 1958–59. Australia maintained its favourable trade surplus with Japan.³²

30 *Official Year Book of the Commonwealth of Australia*, no. 44—1958, p. 346 and no. 49—1963, p. 551.

31 Taken from *Official Year Book of the Commonwealth of Australia*, no. 44—1958, p. 354.

32 *Official Year Book of the Commonwealth of Australia*, no. 46—1960, p. 483.

Japan becomes Australia's major trading partner

1960s—Australia's trade links with Japan expand and strengthen

5.32 The importance of the United Kingdom as a trading partner continued to decline throughout the 1960s. In 1961, Britain commenced negotiations to join the European Economic Community (EEC) and, although it did not become a member until 1972, it, in effect, broadcast its intention to shift its trading focus from Commonwealth countries, such as Australia, to markets closer at hand.

5.33 During the 1960s, wool, which had traditionally been the mainstay in exports to Japan, held its dominance, followed by wheat, meat and dairy products. To an extent, Japan filled the void created by the weakening demand for agricultural products from Australia's established export markets in the United Kingdom and Europe. During the 1960s, there was a marked increase in the share of Australia's agricultural exports going to Japan and the United States, and a decline in the relative importance of the more traditional markets of the United Kingdom and Europe. According to Professor Crawford, over the period 1960–61 and 1973–74, agricultural exports to Japan, as a percentage of all Australian agricultural exports, grew from 17.7% to an estimated 26.8%, while the United Kingdom's share of Australia's agricultural exports fell from 24.1% to an estimated 6.4%. The value of cereal grains and cereal preparations exported to Japan almost doubled between 1966–67 and 1968–69. In this decade, Australia established itself as one of Japan's main suppliers of food products.³³

5.34 Professor Crawford maintained that this growth came about largely because of a number of interacting factors: the rising high per capita income growth in Japan and changing taste patterns away from traditional style foods towards more Western consumption patterns. This brought about an increase in the consumption of meat, eggs, dairy products, fruit, vegetables, sugar and fish, and created a demand in foodstuffs that Japan was unable to meet. Its inability to expand its domestic production of most agricultural products was compensated in part by Australia's ability to maintain or increase its share of the Japanese import market.³⁴

5.35 As well as emerging as Australia's major export market for agricultural products, Japan at this time was fast assuming global stature as a major industrial power and was creating a massive demand for raw materials. This expansion by Japan into heavy industries such as steel, chemicals, automobiles and shipbuilding proved a boon for Australia's mineral sector and strengthened the already well-established complementarity of trade between the two countries.

33 J.G. Crawford, Kenzo Hemmi, et al, 'Australian Agriculture and Trade with Japan', Australian Japan Economic Relations Research Project, July 1975, p. 134.

34 J.G. Crawford, Kenzo Hemmi, et al, 'Australian Agriculture and Trade with Japan', Australian Japan Economic Relations Research Project, July 1975, p. 86.

5.36 This upsurge in industrial activity in Japan was accompanied by the discovery of rich mineral deposits in Australia. This fortunate coincidence, further complemented by the rapid development and innovation in technology and modes of transport which made the extraction and handling of materials much easier, created a dynamic environment in which both countries promoted their mutual trading interests and fostered a closer relationship. Mr Richard Pomfret cited the development of very large-scale equipment and 100,000 tonnes plus capacity bulk carriers as an example of advances in transport which facilitated the export of ores from the open-cut iron ore mines of Western Australia and the coal mines of Queensland.

5.37 He also noted similar developments based on technology advances and large-scale capital-intensive operations, which marked the growth of bauxite mining and alumina refining.³⁵ Such large-scale and ambitious projects were sponsored by Japanese investment, which added another dimension to the Australia-Japan relationship. Mr Peter Robinson made the point:

It was the forward contracts offered by Japanese industry which formed the basis for financing the vast mineral projects which made such an export record possible. Virtually no Australian Government commitment to these developments was necessary and Australian private investment—at least in the initial stages—was small by comparison with the loan capital which was raised abroad (mainly in the US) on the security of the Japanese contracts.³⁶

In other words, according to Mr Robinson, Japan—to advance its own interests—virtually underwrote the mineral development of Australia during this period.³⁷

5.38 Export revenues in iron ore and coal grew substantially as these new mining projects got underway to satisfy the hungry appetite of Japan's emerging iron and steel industry. Between 1966–67 and 1968–69, the value of metalliferous ores and metal scrap exported to Japan jumped in value from \$85.3 million to \$215.2 million and coal from \$68.7 million to \$114.8 million.³⁸

35 Richard Pomfret, 'Australian Experience with Exporting to Asia', Centre for International Economic Studies, University of Adelaide, January 1996, p. 27.

36 Peter Robinson, *Towards a Total Partnership: A View of Australian-Japanese Trade Relations, 1977*, p. 21.

37 Peter Robinson, *Towards a Total Partnership: A View of Australian-Japanese Trade Relations, 1977*, p. 21.

38 *Official Year Book of the Commonwealth of Australia*, no. 56—1970, p. 307.

5.39 Table 5.3 shows the trend in the value of Australia's main exports to Japan. It highlights the dramatic increase in Australian exports of metalliferous metals and coal during the latter half of the 1960s.

Description	1966-67 \$m	1967-68 \$m	1968-69 \$m	1969-70 \$m
Meat and meat preparations	16.4	26.0	20.1	31.6
Cereal grains	38.8	40.6	77.1	65.2
Sugar and honey	21.5	23.9	27.0	36.6
Textile fibres	274.5	246.0	264.4	259.1
Metalliferous ores	85.3	143.9	215.2	328.2
Coal	68.7	84.26	114.9	155.9
Non-ferrous metals	16.1	20.7	21.8	41.9 ³⁹

5.40 In 1966-67, Japan, after years of gradually narrowing the gap, finally supplanted the United Kingdom as Australia's largest export market and has held that position since.⁴⁰

5.41 Table 5.4 shows the declining importance of the United Kingdom as an export destination for Australian exports and the growing importance of Japan.

39 Figures taken from *Official Year Book of the Commonwealth of Australia*, no. 56—1970, p. 307 and no. 57—1971, p. 302.

40 *Official Year Book of the Commonwealth of Australia*, no. 56—1970, p. 303.

Table 5.4—Values of Australian Recorded Exports: Proportions by country of origin or consignment, 1963—69.

Figures expressed as a percentage of Australia's total exports

	1963–64	1964–65	1965–66	1966–67	1967–68	1968–69
	%	%	%	%	%	%
United Kingdom	18.40	19.47	17.40	13.39	13.94	12.59
Japan	17.53	16.62	17.29	19.39	21.09	24.36
United States	10.09	9.96	12.44	11.88	13.22	14.23 ⁴¹

Imports from Japan

5.42 Overall, during the 1960s, Australian imports from Japan increased steadily from 6% of total Australian imports in 1960–61 to 9% in the middle of the decade to just under 12% at the close of the decade. The main Japanese products imported by Australia were textile yarn, fabrics and made up articles followed by transport equipment, machinery (except electric), iron and steel, electric machinery and miscellaneous manufactured articles. By the end of the 1960s, transport machinery had become Australia's most important import from Japan, followed by textile yarn, fabrics and made up articles.⁴²

1970s—Japan's increasing dominance as Australia's trading partner

5.43 During the 1970s, Japan consolidated its position as Australia's major trading partner. In 1971–72, it took 27.8% of Australia's total exports and by the middle of the decade this had climbed to over 30%. In 1977–78, as Australia's principal export market, it took 32.3% of total Australian exports.⁴³

5.44 The rising level of personal income in Japan continued to bring about change in the nature of the Japanese diet. There was an increased demand for foodstuffs high in protein such as beef. This shift in consumer tastes led to a growing dependence on imported food and Australia was happy to help meet this increase in demand.⁴⁴

41 Figures taken from *Official Year Book of the Commonwealth of Australia*, no. 53—1967, p. 393 and no. 56—1970, p. 303.

42 *Official Year Book of the Commonwealth of Australia*, no. 56—1970, p. 315.

43 *Official Year Book of the Commonwealth of Australia*, no. 59—1973, p. 302; no. 63—1979, p. 586.

44 Saburo Okita, 'Japan's High Dependence on Natural Resources Imports and its Policy Implications', Japan Economic Research Centre, Australia-Japan Economic Relations Research Project, April 1975, p. 3.

5.45 But Japan was becoming worried about its high dependence on imported food and the desire for improved self-sufficiency in agriculture came to dominate Japanese policy thinking in this area.⁴⁵ Nonetheless, Japan continued to look favourably on Australian exports in foodstuffs, which grew in value.

5.46 In 1976, the Prime Ministers of Australia and Japan signed a treaty of friendship and co-operation, which recognised their mutual interest in being ‘a stable and reliable supplier to and market for the other’. They agreed ‘to promote the further strengthening and development of trade’ between the two countries on ‘a fair and stable basis’. The treaty also acknowledged the growing importance of mineral resources, including energy resources, and the Prime Ministers agreed to cooperate in the trade and development of these resources.⁴⁶

5.47 Indeed, at this time, minerals gradually eclipsed agricultural products as Australia’s most important export commodity to Japan. In large measure, this growth in exports to Japan was due to the rising Japanese demand for Australian minerals and the rapid development of Australia’s capacity to ensure that Japan’s growing needs were reliably supplied.

5.48 As Japan’s iron and steel industry continued to expand—Japanese crude steel output in 1973 totalled 119 million metric tons—Australia became the main supplier of iron ore to Japan.⁴⁷ In 1970–71, wool was dislodged as Australia’s principal export commodity by iron ore and concentrates.

5.49 The oil crisis in 1973 gave Japanese policy makers a savage jolt. The sharp increase in petroleum price and the uncertainty over supply exposed the vulnerability of Japan’s energy supply. In the most alarming way, the crisis made Japan aware of its heavy reliance on foreign energy supplies and how this in turn flowed through to the economy and affected the level of economic activity.

5.50 At the time, Mr Saburo Okita observed:

The current oil crisis has once again demonstrated to Japan its high dependency upon supplies of natural resources from abroad. When these supplies of foreign resources are obtained smoothly, the Japanese economy

45 J.G. Crawford, Kenzo Hemmi, et al, ‘Australian Agriculture and Trade with Japan’, Australian Japan Economic Relations Research Project, July 1975, p. 110.

46 Basic Treaty of Friendship and Co-operation between Australia and Japan, signed in Tokyo 16 June 1976 and came into force on 21 August 1977.

47 Saburo Okita, ‘Japan’s High Dependence on Natural Resources Imports and its Policy Implications’, Japan Economic Research Centre, Australia-Japan Economic Relations Research Project, April 1975, p. 6.

progresses favourably, however, once imports are interrupted, the impact on the Japanese economy is immediate and severe.⁴⁸

5.51 The shock of the oil crisis forced Japan to examine its high dependency on overseas resources and to consider ways to deal with this situation. The Japanese Government encouraged industries to adopt an energy-saving and resource-saving approach. Mr Okita noted the range of options available to Japan:

Policies such as diversifying sources of supply, economizing on the use of raw materials and energy, stepping up efforts for increased production from indigenous resources, and building up emergency stocks of energy and food are feasible and should be pursued with seriousness.⁴⁹

5.52 Despite recognising the need to better manage their dependence on foreign sources of raw material, the Japanese accepted that the basic character of their heavy dependence for key items on overseas resources would remain. Measures such as the diversification of resource supply were accepted by Japan as both wise and necessary.⁵⁰

5.53 Japan's obvious need for a reliable source of raw materials to sustain manufacturing production worked to Australia's advantage and Japan, in seeking to diversify its source of energy and raw material, turned to products such as coal and natural gas.

5.54 Indeed, coal exporters benefited from the oil crisis and from Australia's low cost production with coal production doubling between 1970 and 1980. In 1978, an Ad Hoc Committee inquiring into Japan observed that 'the availability of relatively cheap sources of power and ready access to local supplies of raw materials suggest that Australia should be able to become an increasingly important world supplier of such products as alumina, aluminium, nickel metal and steel'.⁵¹ By the late 1970s, metalliferous ores and coal were Australia's most important exports to Japan.⁵²

48 Saburo Okita, 'Japan's High Dependence on Natural Resources Imports and its Policy Implications', Japan Economic Research Centre, Australia-Japan Economic Relations Research Project, April 1975, p. 1.

49 Saburo Okita, 'Japan's High Dependence on Natural Resources Imports and its Policy Implications', Japan Economic Research Centre, Australia-Japan Economic Relations Research Project, April 1975, p. 11.

50 Saburo Okita, 'Japan's High Dependence on Natural Resources Imports and its Policy Implications', Japan Economic Research Centre, Australia-Japan Economic Relations Research Project, April 1975, p. 11.

51 *Report of the Ad Hoc Working Committee on Australia-Japan Relations*, Canberra, May 1978, p. 78.

52 *Official Year Book of the Commonwealth of Australia*, no. 65—1981, p. 639 and no. 68, p. 616.

5.55 The following table shows the value of Australia's major exports to Japan from 1968–69 to 79–80. It demonstrates the significant jump in the value of metalliferous ores and coal during this period.

Description	1968– 1969	1969– 1970	1970– 1971	1971– 1972	1972– 1973	1974– 1975	1976– 1977	1977– 1978	1979– 1980
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Meat and meat preparations	20.1	31.6	41.4	78.4	189.0	45.2	172.9	207.3	370.9
Cereal grains	77.2	65.2	92.0	158.5	111.5	314.9	316.0	262.1	331.7
Sugar and honey	27.0	36.6	47.0	62.2	74.3	109.0	275.4	218.1	279.5
Textile fibres	264.4	259.1	199.9	221.3	500.7	233.9	455.9	357.0	445.4
Metalliferous ores	215.2	328.2	446.5	424.9	505.0	758.1	992.4	992.8	1,378.0
Coal	114.8	155.9	173.0	198.6	260.9	508.6	1,048.6	1,091.5	1,207.8
Non-ferrous metals	21.8	41.9	41.6	32.1	(a)	70.8	74.2	78.0	71.9 ⁵³

5.56 During the first half of the 1970s, changes also occurred in the composition of Japanese goods imported by Australia, which centred on transport equipment; textile yarn; fabrics and made up articles; machinery; and iron and steel. By the end of the 1970s, however, road vehicles dominated Japanese exports to Australia. Telecommunications, recording and reproducing apparatus and equipment became the second most significant import item from Japan. Iron and steel, as well as machinery, remained important. Although textile yarn and fabrics had lost ground, it nonetheless was still the fifth most important export from Japan to Australia. Japan's share of Australia's import market was 15.7% in 1971–72 and, with slight fluctuations, settled around this figure throughout the decade. Australia continued to run a trade surplus with Japan.⁵⁴

53 Figures taken from *Official Year Book of the Commonwealth of Australia*, no. 56—1970, p. 307; no. 57—1971, p. 302; no. 58—1972, p.306; no. 59—1973, p. 305; no. 60—1974, p. 327; no.61—1975 and 1976, p. 343; no. 62—1978, p. 657; no. 63—1979, p. 595; no. 65—1981, pp. 639–40. The high figure given for meat and meat preparations for 1972—73 is that given in the year book for 1974.

54 *Official Year Book of the Commonwealth of Australia*, no. 59—1973, p. 302; no. 65—1981, p. 640.

1980s—Growing diversity and complexity in trading activities

5.57 Despite changing global trading patterns with the growth and development in manufacturing and technology, Australia throughout the 1970s and into the 1980s, became locked into a situation of ‘commodity dependence’ where iron ore, coal, wool, grains and beef made up the lion’s share of its exports.⁵⁵ The Australian Government recognised that the country relied heavily on this handful of commodities for its economic prosperity and that a concerted trade diversification and expansion strategy was needed to broaden the range of Australian exports. Improved access to Japanese markets was just one aspect of a multi-pronged strategy to cultivate new and diverse markets.⁵⁶

5.58 Until the early 1980s, the Australian Government followed a policy that focused on protecting its domestic industries and maintaining existing levels of market access in Japan. During the 1980s, however, Australia began to pursue a trade policy that strongly advocated an ‘open international trade and payments system’ and ‘an equitable framework of rules based on the principles of multilateralism, non-discrimination, predicability and transparency’. The new approach called for progressive trade liberalisation. Australia looked to promote fair and predictable access to major markets, to place restraints on subsidised competition in third markets and to encourage stability in commodity markets.⁵⁷

5.59 The share of Australian exports destined for Japan as a percentage of total Australian exports declined from its peak of over 35% in 1976 to 26% in 1983.⁵⁸ Over the same period, Australia’s penetration of the Japanese market also declined steadily from more than 8% in the mid-1970s to 5% in 1984. In part, Australia was losing its share of a growing Japanese market because of changes in Japan’s economic structure and changes in its demand for imports.⁵⁹ Although exports to Japan declined, Australia remained heavily dependent on Japan as its major market for mineral and agricultural commodities. Farm products comprised almost 40% of exports, and mining and basic metals manufacture made up over 40%. Wool, after a dramatic

55 Jamie Anderson, ‘Australia’s Market Access Agenda Towards Japan’, *Pacific Economic Papers*, no. 291, Australia-Japan Research Centre, May 1999, p. 2. He wrote that in 1993 iron ore, coal, wool and beef accounted for 62% of Australia’s exports.

56 Jamie Anderson, ‘Australia’s Market Access Agenda Towards Japan’, *Pacific Economic Papers*, no. 291, Australia-Japan Research Centre, May 1999, p. 2.

57 This policy statement appeared in Year Book Australia 1983 and in subsequent editions. See *Official Year Book of the Commonwealth of Australia*, no. 67—1983, p. 664.

58 Jamie Anderson, ‘Australia’s Market Access Agenda Towards Japan’, *Pacific Economic Papers*, no. 291, Australia-Japan Research Centre, May 1999, p. 2.

59 *Report of the High-Level Trade Mission to Japan*, July 1984, AGPS, Canberra 1984, p. 1.

decline in its export share to Japan in the late 1960s and 1970s, stabilised at slightly over 10% of exports in 1988 associated with higher wool prices.⁶⁰

5.60 After a minerals led investment boom in the early 1980s, export of energy minerals to Japan grew rapidly, especially coal but also including oil and gas which began to assume a prominent role in Australia's exports. Coal increased its share of trade from about 15% in the mid 1960s to over 30% in the mid 1980s, with the share in 1988 of about 22%. According to Professor Drysdale, exports of LNG from the North West Shelf were set to grow rapidly over the coming decade.⁶¹

5.61 One encouraging development in the 1980s was the rapid rise of the manufactures component in Australia's exports to Japan—from a mere 3.2% of total exports to Japan in 1980, it increased to 14.7% in 1990 peaking at 17.7% in 1988.⁶² In 1984, the Minister for Trade wrote:

A long-term view of building Australian manufacturing and services into Japan's plans for the 21st century needs to be adopted. This will require the Department of Trade to foster a stronger export orientation in the Australian manufacturing community at large and it will involve the setting of priorities for export products and markets.⁶³

5.62 Fish and fish products emerged in the 1980s as a growing Australian export product for Japan. In 1979–80, it was valued at \$132 million, an increase from its 1977–78 valuation of \$71 million. The market has continued to grow in importance and was an indication of the growing diversity of Australian exports to Japan and the potential that was opening for new markets.⁶⁴

5.63 Table 5.6 shows the overall value of Australia's main export commodities to Japan but, in particular, the increasing value of exports from the mineral sector, especially coal, to Japan during the early 1980s.

60 Peter Drysdale, Nancy Viviani, Akio Watanabe and Ippei Yamazawa, *The Australia-Japan Relationship: Towards the Year 2000*, Australia-Japan Research Centre and Japan Centre for Economic Research, Canberra & Tokyo, 1989, p. 18.

61 Peter Drysdale, Nancy Viviani, Akio Watanabe and Ippei Yamazawa, *The Australia-Japan Relationship: Towards the Year 2000*, Australia-Japan Research Centre and Japan Centre for Economic Research, Canberra & Tokyo, 1989, p. 18.

62 H.S. Kehal, 'Implications for Australian Trade of the Recession in Japan', *Current Affairs Bulletin*, vol. 69, no. 1, June 1992, p. 29.

63 Foreword to *Report of the High-Level Trade Mission to Japan*, July 1984.

64 *Official Year Book of the Commonwealth of Australia*, no.63, 1973, p. 595; no. 65, 1981, p. 639.

Table 5.6—Value of Australia's main export commodities to Japan, 1980–85

Description	1980–81 \$m	1981–82 \$m	1982–83 \$m	1984–85 \$m
Meat and meat preparations	350.3 (4)	323.4 (5)	397.4 (4)	401.7 (5)
Cereal grains	307.7 (6)	342.8 (4)	246.9 (5)	587.3 (4)
Sugar honey	308.9 (5)	141.1 (7)	85.4 (8)	22.2 (7)
Textile fibres	468.3 (3)	506.5 (3)	501.9 (3)	598.7 (3)
Metalliferous ores	1,019.1 (2)	1,113.5 (2)	1,321.3 (2)	1,553.5 (2)
Coal	1,404.3 (1)	1,563.5 (1)	2,004.6 (1)	2,596.9 (1)
Fish	113.8	158.0 (6)	177.5 (7)	183.5 (6) ⁶⁵

Services

5.64 Trade in services between the two countries increased markedly during the 1980s, especially in the areas of financial services and tourism. While only small in absolute terms, this sector was growing very rapidly in importance as the economic relationship changed in scope and extent.⁶⁶

5.65 During the 1980s, tourism emerged as a growing and very important industry. By the close of the decade after an unprecedented growth spurt, it was estimated that tourism contributed 5.4% to GDP and employed nearly 6% of the workforce. Overseas tourists made a significant contribution to the importance of the tourist industry. Foreign exchange earnings from international tourism reached \$6.2 billion in 1988–89 which exceeded export earnings for many of Australia's established export commodities.

5.66 At this time, government officials recognised the potential for overseas tourism to redress Australia's balance of payment deficit. The Australian Bureau of Statistics found that:

65 Figures taken from *Official Year Book of the Commonwealth of Australia*, no. 66—1982, p. 648; no. 67—1983, p. 687; no. 68—1984, p. 616; no. 70—1986, p. 610.

66 Peter Drysdale, Nancy Viviani, Akio Watanabe and Ipppei Yamazawa, *The Australia-Japan Relationship: Towards the Year 2000*, Australia-Japan Research Centre and Japan Center for Economic Research, Canberra & Tokyo, 1989, pp. 59–61.

Investment in the industry has flourished and tourism has been a major inducement to the inflow of foreign capital. Over the three years to March 1990, the value of major tourist projects under construction or firmly committed has more than doubled to around \$21 billion. This indicates investor confidence in the long term viability of the industry.⁶⁷

5.67 The dramatic increase in Japanese tourists over this period had a significant influence in boosting the figures. In 1981, 53,699 Japanese tourists visited Australia, this soared to 479,900 in 1990, when Japan became Australia's largest source country for overseas tourists.⁶⁸

5.68 The following table shows the overall sharp increase in overseas tourists to Australia and most importantly the growing importance of Japanese tourists to this industry.

Country	1978	1981	1984	1986	1988	1990
New Zealand	200,187(1)	284,372	234,400	336,700	534,300	418,400
Unites States	80,972(3)	113,964	160,000	245,300	322,300	250,500
United Kingdom	91,455(2)	145,957	145,000	176,000	260,300	277,700
Japan	34,035(4)	53,699	87,900	145,600	352,300	479,900
Canada	19,009(5)	30,948	34,500	47,000	66,700	53,700
Germany	18,415(6)	39,055	34,200	41,900	65,900	74,200
Singapore	9,306(7)	19,621	33,000	45,000	63,500	75,900 ⁶⁹

67 *Year Book Australia, 1991*, no. 74, Australian Bureau of Statistics, Canberra, 1991, pp. 378–9.

68 *Official Year Book of the Commonwealth of Australia*, no. 67—1983, p. 748; no. 75—1992, p. 388.

69 Figures taken from *Official Year Book of the Commonwealth of Australia*, no. 64—1980, p. 745; no. 67—1983, p. 748; no. 70—1986, p. 684; no. 71—1988, p. 482; no. 73—1990, p. 381; no. 75—1992, p. 388.

Foreign Investment

5.69 The emerging emphasis on the exchange of services was matched in the foreign investment sector. The rate of investment in Australia increased by over 50% between 1984–85 and 1987–88. This very large increase was accompanied by an even larger change in the distribution of investment by broad sector.

5.70 Japan contributed to this growth in investment. During the 1980s, the level of Japanese foreign investment in Australia increased substantially. In 1980–81, the amount stood at just over \$4 billion; by 1985–86, it had more than quadrupled to over \$20 billion. Nonetheless, the United States and the United Kingdom were by far the most important foreign investors in Australia during the mid-1980s. In 1986–87, Japanese investment in Australia was just over half that of the United States and the United Kingdom. By 1989, however, Japan with over \$45 billion invested in Australia, had drawn almost equal to the United States and the United Kingdom. Although Japan did not dominate foreign investment in Australia, its high-profile presence in this area provoked wide public debate.⁷⁰

5.71 It was the nature and extent of Japanese investment rather than the investment itself that sparked controversy in Australia. Towards the end of the decade the substantial purchases of real estate by Japanese companies stirred anti-Japanese feelings in some sectors of the Australian community. Throughout the late 1980s and into the early years of the 1990s, Japanese investors turned to the tourist industry and real estate as their main targets for investment. According to Mr Purnendra Jain, Japanese investment in tourism reached \$1.4 billion and investment in real estate exceeded \$400 million. Much of the investment had been connected with popular tourist areas such as Cairns and the Gold Coast in Queensland.⁷¹ This very public foreign investment provoked some Australians to question the economic benefits that it would bring to the local community.⁷²

5.72 While Japan's direct investment in resources, automobile manufacturing and tourism was widely recognised in Australia, Australia's investment in Japan was minuscule.

70 Purnendra Jain and Donna Weeks, 'Australia and Japan: Banking on the "Constructive Partnership"', *Current Affairs Bulletin*, vol. 69, no. 9, February 1993, p. 14. *Official Year Book of the Commonwealth of Australia*, no. 71—1988, p. 909. See figures given for levels of investment in *Official Year Book of the Commonwealth of Australia*, no.72, 1992, p. 725. Note these figures differ slightly from Table 5.8—see footnote 71 for explanation.

71 Purnendra Jain and Donna Weeks, 'Australia and Japan', *Current Affairs Bulletin*, vol. 69, no. 9, February 1993, p. 14. *Official Year Book of the Commonwealth of Australia*, no. 71—1988, p. 909. See also *Year Book Australia 1991*, Australian Bureau of Statistics, Canberra, 1991, p. 379.

72 Purnendra Jain and Donna Weeks, 'Australia and Japan', *Current Affairs Bulletin*, vol. 69, no. 9, February 1993, pp. 13–14.

5.73 The following table shows the value of foreign investment in Australia by Australia's main overseas investors.

Country	1986–87 \$m	1987–88 \$m	1988–89 \$m	1989–90 \$m	1990–91 \$m
United States	41,698	40,108	47,183	46,648	54,237
United Kingdom	38,323	44,073	48,031	46,291	49,147
Japan	22,551	29,615	38,670	46,412	50,189 ⁷³

Japanese imports

5.74 During the 1980s, the pattern of Japanese imports into Australia remained fairly constant, with motor vehicles dominating imports together with a range of manufactured goods. In 1988–89, Japan held a 20.75% share of Australia's total import market.

Conclusion

5.75 Thus, at the beginning of the 1990s, Japan stood as the leading nation among Australia's export partners and one of the most important sources of Australia's imports. The economies of both countries had grown considerably since the war and their relationship had matured into a friendly and mutually beneficial partnership.

5.76 For over 40 years, Australia's trading fortunes have been closely tied to those of Japan and Australia has benefited from Japan's economic prosperity. For the last ten years, however, Japan has been beset by economic problems that have seen the economy falter and gradually sink into recession. As Japan's economic troubles deepened in the 1990s, many economists in Australia feared that Australia's trading

73 *Year Book Australia 1994*, no. 76, p. 791. These figures are subject to review by the Australian Bureau of Statistics. The Year Book for 1997 shows that although Japan was certainly narrowing the gap between its level of investment in Australia with that of the US and the UK, it did not eclipse the UK in 1989–90 or 1990–91. In 1990–91 Japan remained third in rank with \$51 billion behind the UK with 54.3 billion and the US with 55.3 billion, *Year Book Australia, 1997*, p. 734. The changes in part are due to a change in collection methodology.

prospects would suffer. As noted by Mr Jammie Penm and industry analysts in Australia:

...developments in Japan are of special concern to Australian commodity producers and exporters. Japan is the world's second largest economy, and the world's largest importer for many commodities—as such, the state of its demand significantly influences world import demand and prices.⁷⁴

74 Jammie Penm and industry analysts, 'Japan: Implications of Japan's low economic growth for Australian exports', *Australian Commodities*, vol. 6, no. 2 1999.

CHAPTER 6

JAPAN'S ECONOMIC WOES AND AUSTRALIA'S PROSPECTS

Introduction

6.1 Having briefly traced the evolution of Australia's trading links with Japan from the 1860s to 1990 when Japan's bubble economy collapsed, the Committee now turns to recent developments in the Japan-Australia trading relationship. The Committee draws on specific sectors within the Australian economy to provide an understanding of how Japan's domestic circumstances and economic troubles have influenced Australia's economic prospects. It also addresses the growing complexity and diversity in Australia's trading relationship with Japan and considers current and potential difficulties in that relationship.

Statistical overview of Australia's trade with Japan from 1990

Share of Australia's export market

6.2 Japan has been Australia's most significant trading partner since 1967. During the mid-1970s, Japan was vital to Australia's economic interests with over 30% of all Australian exports going to Japan. Although its dominant share of Australia's total exports has gradually slipped back, Japan at the beginning of 1990 held its position as Australia's principal export destination and second largest import supplier. It accounted for a substantial 26% of Australia's exports and 19% of imports.¹

6.3 Clearly, over the years, Australia had become heavily reliant on Japan as an export market, especially for key Australian exports such as coal, iron ore, wheat and beef. The unprecedented growth in the tourist industry, which by 1990 was making a major contribution to national economic development, was due in part to the increasing number of Japanese visitors who, by this time, were the single most important tourist group to Australia. By 1990, they made up 21.7% of all overseas visitors to Australian shores.² Moreover, by 1990, Japanese investment in Australia was the third largest and almost matched that of the United States and the United

1 Australian Bureau of Statistics, 'Australia Now—A Statistical Profile, International Accounts and Trade, Feature Article—Australia's Merchandise Trade with Japan', (March 1999) <http://www.abs.gov.au/Australia/websitedbs/c311/BDE7ACE2081C70E6CA25677B00077C49> (30 November 2000). The US is Australia's second most important trading partner, it takes around 19% of Australia's total exports and supplies Australia with over 20% of its imports.

2 By 1990, Japanese tourists had eclipsed the number of New Zealand visitors who made up 18.9% of the market; *Official Year Book of the Commonwealth of Australia*, no. 75—1992, p. 389.

Kingdom.³ So, at the beginning of the 1990s, Japan occupied a central position in Australia's trading interests. This close relationship meant that the effects from any major economic developments in Japan would flow through to the Australian economy and affect Australia's economic growth through its international trading activities.

6.4 Thus, when the Japanese economy started to slow in the early 1990s and edged toward recession in the latter half of the decade, most economic analysts expected Australia would suffer directly through its trade and financial linkages. They predicted that subdued economic activity in Japan would soften demand for Australian products and hence damage Australia's potential for economic and export growth.⁴

6.5 To some extent such expectations have been correct. Since 1990, when Japan entered a prolonged period of sluggish economic activity, its dominance as an export destination for Australian products and as a supplier of goods to Australia has been eroded. Even so, Australia's export trade to Japan has held up well to date and Japan still retains its position as Australia's single largest export market.⁵

6.6 Japan's share of Australia's total exports fell from 23% in 1995 to below 20% in 1996.⁶ In 1997, exports to Japan accounted for 19.8% of total exports. Australia's export growth to Japan slowed in 1998 and Japan's share of Australia's total export trade dipped slightly to 19.6%, falling to 19.2% in 1999.⁷

Japanese imports to Australia

6.7 The United States has been Australia's major source of imports for many years. After the United States, Japan is Australia's second largest source of overseas goods. In 1989, Japan held a 20% share of Australia's import market. Over the last decade, this share has declined to around 14%. Imports from Japan stood at \$A13.3 billion or 13.8% of total imports in 1998. This share of total imports slipped to 13.4%

3 The official figures produced by the Australian Bureau of Statistics show the following levels of investment in Australia for 1989–90 in \$ million: US—46,386; UK—46,092 and Japan—45,364, *Official Year Book of the Commonwealth of Australia*, no. 75—1992, p. 711.

4 DFAT, submission no. 32, pp. 64–5; NSW Government, submission no. 25, p. 10.

5 Barry Jones, Department of Industry, Science and Resources, *Committee Hansard*, 28 May 1999, pp. 690 and 695.

6 Trade Analysis Branch, Department of Foreign Affairs and Trade, June 1999, *Exports of Primary and Manufactured Products, Australia 1996*, Canberra, p. 12.

7 NSW Government, submission no. 25, p. 1; Market Information and Analysis Unit, Department of Foreign Affairs and Trade, *Composition of Trade Australia, 1998*, Canberra, p. 44; Trade Analysis Branch, Department of Foreign Affairs and Trade, *Exports of Primary and Manufactured Products Australia, 1997*, p. 7; Barry Jones, Department of Industry, Science and Resources, *Committee Hansard*, 28 May 1999, pp. 689–90; DFAT, submission no. 32, p. 33 (DFAT gave the figure of 19.5% of total exports for 1997 and 13% of total imports). Additional information supplied to the Committee by DFAT, 18 May 2000.

in 1999. Although Japan's share of Australia's market has fallen, it retains its position as Australia's second major source of imports. The United Kingdom holds third place, although its share of the Australian market has also declined over two decades from 11.5% to 6.2%. Countries such as China, the Republic of Korea and Indonesia have increased their share of the Australian market since 1977 by 4.8%, 3.1% and 2.4% respectively.⁸

6.8 The following table shows the gradual decline in Japan's share of Australian exports and the fall in Japan's share of total Australian imports since 1989.

Table 6.1—Australia's merchandise trade and trade share with Japan 1989–1998.

	Exports to Japan	Share of Australia's total exports	Imports from Japan	Share of Australia's total imports	Balance of trade with Japan
	\$m	%	\$m	%	\$m
1989	12,441	26	10,508	20	1,933
1990	13,441	26	9,358	19	4,083
1991	14,820	28	8,728	18	6,092
1992	14,749	25	10,037	18	4,712
1993	15,627	25	11,885	19	3,742
1994	15,993	25	12,100	18	3,893
1995	16,566	23	11,965	15	4,601
1996	15,565	20	10,213	13	5,352
1997	16,814	20 (19.8%)	11,409	14	5,405
1998	17,403	20 (19.6%)	13,319	14	4,084 ⁹

8 Market Information and Analysis Unit, Trade Development Branch, Department of Foreign Affairs and Trade, February 1999, *Australian Basic Trade Statistics 1997–98*.

9 Australian Bureau of Statistics, 'Australia Now—A Statistical Profile', International Accounts and Trade, Feature Article—Australia's merchandise trade with Japan, <http://www.statistics.gov.Australia/w.../bde7ace2081c70e6ca25677b00077c49?OpenDocument> (30 November 1999) (page 2 of 15).

Australia's share of the Japanese import market

6.9 Even though the growth in Australia's exports to Japan has continued to decline, Australia's share of the Japanese import market has increased marginally in the last few years. Australia's overall market share in Japan increased from 4.1% in 1996 to 4.3% in 1997, reversing a downward trend over recent years. Australia improved its ranking from being Japan's eleventh most important trading partner in 1997 to rating as seventh in 1998. In general, Australia performed better than its competitors in the Japanese market—it managed not only to maintain its share of a diminishing market but to increase this share slightly. Austrade pointed out that in 1998, Japan's global imports declined by 10.5% but Australian imports into Japan declined by only 3.6%.¹⁰ In 1999, however, Australia's share of Japan's import market fell back to its 1996 share of 4.1%.¹¹

6.10 Although the growth rate of Australian exports to Japan has slowed, the decline in Australian exports to Japan has not been severe. This is due in large measure to the depreciation of the Australian dollar against the United States dollar and against major European Union currencies.¹² Thus, according to DFAT, the concern that Australian trade with Japan would suffer has not been fully realised because the 'realistic' level of the Australian dollar largely cushioned Australian exporters, resulting in a rise in Australia's share of Japan's import market in 1998 with a slight fall in 1999.¹³

Economic slowdown in Japan and its effects on Australia

6.11 Although any negative effect on Australian trade stemming from reduced economic activity in Japan has been largely offset to date by the increased competitiveness of Australian exports resulting from, among other things, the depreciation of the Australian dollar, the fear lingers that any deepening or prolongation of the recession in Japan could further dampen Japan's demand for Australian products.¹⁴

6.12 The exchange rate that favoured Australian exports by giving them a competitive edge explains in part why Japanese demand for Australian goods did not fall away steeply. The trading relationship between Australia and Japan, however, is complex and there are many other factors at work that have helped buffer Australia

10 Greg Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 628; Colin Heseltine, DFAT, *Committee Hansard*, 15 February 1999, pp. 2–3; NSW Government, submission no. 25, p. 1.

11 Additional information supplied to the Committee by DFAT, 18 May 2000.

12 DFAT, submission no. 32, pp. 65–7; ABARE, submission no. 21, p. 10.

13 DFAT, submission no. 32, p. 65; Dr Terence Sheales, ABARE, *Committee Hansard*, 21 June 1999, p. 731.

14 Queensland Government, submission no. 18, p. 1; Dr Terence Sheales, ABARE, *Committee Hansard*, 21 June 1999, p. 731.

against the ill winds of Japan's economic troubles. The strong relationship between the two countries that spans many years and the reputation that Australia has built up as a reliable supplier and dependable trading partner provides a solid platform for future growth in the Australia-Japan relationship despite economic difficulties. Mr Fuyuki Kitahara, President of the Japanese Chamber of Commerce in Sydney, suggested:

Despite negative growth in Japan for the past two fiscal years, the impact on Australia in these key areas has not been negative to the extent that might have been expected. My personal view is that the comparatively small downwards movement is the direct reflection of the fact that Japan places a high priority on Australia in these areas based on quality, competitiveness and stability.¹⁵

6.13 Notwithstanding Australia's good name as a reliable and stable trading partner, slow economic growth in Japan will mean continuing weak demand for Australian goods, which will in turn exert downward pressure on both volume and prices. Exports likely to suffer from expected continuing low growth include Australia's rural commodities, especially wool, seafood, forest products and possibly cotton. According to the Australian Bureau of Agricultural and Resource Economics (ABARE), the effects on wheat, sheepmeat and dairy products are not expected to be significant in the short term. Luxury goods, such as abalone, rock lobster and prawns, will be particularly vulnerable to soft demand.¹⁶

Australia's export industry and its heavy reliance on a handful of commodities

6.14 Even though Australia's trade with Japan over the decades has diversified, it nonetheless is built around a tight cluster of core commodities. Throughout the 1990s, Australia remained heavily dependent on mineral and agricultural exports.¹⁷ Five commodities, all from primary industry, accounted for over half of Australian exports of \$16 billion in 1994—coal, beef, gold, iron ore and natural gas.¹⁸ In 1996, the export of non-monetary gold to Japan fell sharply and has not recovered. In 1997–98, Japan accounted for around 17% of agricultural, 17% of mineral and 42% of energy exports from Australia. The total value was in excess of \$8 billion dollars.¹⁹

15 Fuyuki Kitahara, Japan Chamber of Commerce, Sydney Inc, *Committee Hansard*, 3 September 1999, p. 802.

16 ABARE, submission no. 21, p.10 and comments by Dr Sheales, ABARE, *Committee Hansard*, 21 June 1999, p. 732; NSW Government, submission no. 25, pp. 10 and 14.

17 Dr Terence Sheales, ABARE, *Committee Hansard*, 21 June 1999, p. 731.

18 Richard Pomfret, 'Australian Experience with Exporting to Asia', *Seminar paper 96-01*, Centre for International Economic Studies, University of Adelaide, January 1996, p. 9.

19 Dr Terence Sheales, ABARE, *Committee Hansard*, 21 June 1999, p. 731. See also Barry Jones, Department of Industry, Science and Resource, *Committee Hansard*, 28 May 1999, p. 690.

6.15 The table opposite shows the value of the major commodities exported to Japan since 1994. The year 1996 shows a significant fall in the value of a handful of major items exported (*) to Japan and in large measure accounts for the 3% drop in Japan's share of Australia's export market.

Minerals and energy exports to Japan

Overview of Australia's mining and energy exports to Japan

6.16 The effects of the economic situation in Japan on exports of minerals and energy commodities to that country will continue to depend largely on whether the commodities are for final consumption in Japan or whether they are for processing and re-export.²⁰ For example, a substantial proportion of Australian exports of metals and metalliferous minerals, such as aluminium and base metals, is consumed in the building, construction, transport and public infrastructure industries. The Department of Primary Industries and Energy believed that these sectors were:

...most likely to be adversely affected by weak economic activity, the effects on Japanese consumption of these commodities in the current economic downturn could be quite significant.²¹

6.17 Despite the recent encouraging signs in the Japanese economy, weakness in domestic demands persists and public investment is still showing a downward trend. Given the subdued domestic demand in Japan, its final consumption of minerals and energy commodities is likely to remain flat until the economy recovers.²² Yet, even with this general softening of demand for Australian minerals and energy supplies, the effect is not spread evenly across all commodities.

Coal

Coal, Australia's major export earner, accounts for between 10% and 12% of total Australian exports, currently generating over \$9 billion per year in revenue. Japan is Australia's principal coal market. In 1992–93, Japan took half of all Australia's coal exports; in 1994–95 it took a 47% share; in 1995–96 a 43% share; in 1996–97 a 46% share before slipping further in 1997–98 to a 44% share. Coal exports to Japan went up marginally in value from just under \$4 billion to just over \$4 billion in 1998 and accounted for 42% of Australia's world wide coal exports.²³

20 Commonwealth Department of Primary Industries and Energy, submission no. 31, p. 7.

21 Barry Jones, Department of Industry, Science and Resource, *Committee Hansard*, 28 May 1999, pp. 691–2.

22 DKR, *Economic Report*, vol. 3, no. 2, 15 February 2000, p. 2; Barry Jones, Department of Industry, Science and Resources, *Committee Hansard*, 28 May 1999, p. 691.

23 *Year Book*, no. 77—1995, p. 774; no. 78—1996, p. 680; no. 79—1997, p. 707; no. 80—1998, p. 775; no. 81—1999, p. 745; no. 82—2000, p. 791.

Table 6.2—Value of major Australian exports to Japan 1994–98

Export item to Japan	1994	1995	1996	1997	1998
	\$'000	\$'000	\$'000	\$'000	\$'000
Coal	3,180,896	3,165,031*	3,543,630	3,958,008	4,148,046
Confidential items ²⁴	1,285,947	2,309,104	2,663,733	3,040,989	2,955,058
Iron ore	1,218,685	1,296,587	1,311,026	1,583,244	1,788,544
Bovine meat	1,612,546	1,562,848*	1,113,188*	1,250,353	1,340,801
Aluminium	765,243	962,009	851,437*	1,143,116	1,257,596
Wood chips	448,463	562,812	530,795*	570,401	607,969
Non-monetary gold	1,372,252	1,197,934	466,299*	205,371	394,126
Copper ores	248,414	230,935	348,737	413,073	381,888
Crude petroleum	537,937	440,915	348,602*	333,802	336,139
Cotton	213,636	165,517	168,310	206,758	302,854
Machinery and transport equipment	305,162	272,590	286,902	317,648	294,714
Animal feed	225,601	229,757	269,209	304,817	293,506
Cheese and curd	148,423	169,853	204,308	215,544	276,263
Crustaceans	388,037	324,149*	309,518	313,876	244,961
Manufactures classified by material	203,516	216,302	210,602	208,360	244,255
Natural gas	1,023,205	759,132 ²⁵

24 The Australian Bureau of Statistics suppresses some detailed trade statistics for confidentiality reasons. The classification 'confidential items' in this table covers commodities such as sugar, rice, wheat and LNG.

Although the value of coal exports to Japan fell to \$A3.8b in 1999, Japan's share of Australia's export coal market increased to 45.1%.²⁶

6.18 While Japan is paramount to Australia as an export market for coal, Australia is important to Japan as a major supplier. Indeed, there is a strong interdependence between the two countries. Over the last decade, Australia has remained Japan's largest source of coal imports, supplying over half its coal needs. In 1998, it met 56% of Japan's coal requirements, a small rise from 52% in 1989.²⁷ In 1999, Australia's share of Japan's import market in coal rose to 57.1%.²⁸

6.19 Essentially, coal is used for steel production; for electricity generation; and for general industrial use—cement, paper manufacture etc.

Coking coal

6.20 The demand for coking or metallurgical coal, which goes into steel mills for steel production, has been falling in recent years. Forces independent of Japan's recession, however, are also at work influencing demand. Globally, coal for the steel industry is in over supply and demand is diminishing. Worldwide trends, especially in the area of technology and environmental concerns, are also influencing demand. Because of more efficient processes, the demand for coking coal is falling in Europe and also in Korea and Taiwan.²⁹ The pressure to lower costs is encouraging the steel mills in Japan and other countries to move to reduce their reliance on the higher quality and higher value coking coals.³⁰

6.21 Dr Christopher Rawlings, Managing Director of QCT Resources Ltd, explained the shift to other steel-making technologies that rely on less coking coal:

In the current downturn we are finding that many of the Japanese companies are taking alternative views to the selection of coking coal. They might take a lower quality coking coal or even a thermal coal to put into their coke blend. They are not that interested at the moment in productivity. Their major producing units—their blast furnaces and coke ovens—are really just ticking over. They are keeping them running; they are not running them

6.1

25 Market Information and Analysis Unit, Department of Foreign Affairs and Trade, *Composition of Trade Australia, 1998*, June 1999, p. 203. The value of wool exported to Japan has declined sharply from \$324,698 million in 1996, to \$310,032 million in 1997 to \$192,553 million in 1998.

26 Additional information supplied to the Committee by DFAT, 18 May 2000.

27 Australian Bureau of Statistics, 'Australia Now—A Statistical Profile', International Accounts and Trade, Feature Article—Australia's merchandise trade with Japan, <http://www.statistics.gov.au/australia/w.../bde7ace2081c70e6ca25677b00077c49?OpenDocument> (30 November 1999) (page 8 of 15).

28 Additional information supplied to the Committee by DFAT, 18 May 2000.

29 Dr Christopher Rawlings, QCT Resources Ltd, *Committee Hansard*, 16 April 1999, p. 492.

30 See Denis Porter, NSW Minerals Council, *Committee Hansard*, 14 April 1999, p. 264.

hard. They have excess capacity in their steel industry—probably 30 per cent to 40 per cent above that actually produced at the moment. As such they have no need for the highest quality coals to drive those blast furnaces and coke ovens.³¹

6.22 It is against this background of over capacity not only in Japan but also in the world steel industry that negotiations have taken place on coking coal, which have produced reductions in both volume and price over recent years. In tonnes, Australia's coking coal exports to Japan went down by 5.1% on the 1997 level.³²

6.23 The prospects for coal and iron ore exports hinge on developments in the steel industry in Japan and also in the power industry. As major purchasers of these bulk commodities, Japanese steel makers exert a substantial influence on Australia's export performance. A recovery in steel production in Japan, will see a significant upturn in Australian exports of those products. Although much of the steel produced in Japan goes into export production directly or into products that are exported, signs for the Japanese steel industry are not promising. The most recent downturn in production translated into reductions in prices for iron ore and coal in the price negotiations that finished early in 1999. There were significant reductions in contract coal prices of up to 18% for hard coking coal, about 13% for steaming coal and iron ore prices of 10% to 11%.³³

6.24 At the beginning of 2000, some steel manufacturers were hopeful of a revival in their industry. Mr James Collins, policy adviser to the Steel Manufacturers Association, observed, however, that the basic problem of the world steel industry was an excess of steelmaking capacity which was 'hanging like an albatross over the world steel market.' Although steel makers in the United States, in particular, are optimistic for their own steel industry, the outlook for Japan is not so encouraging. Japanese producers have been scaling back raw-steel production to the lowest levels in decades in response to recessions in both their domestic market and in their other Asian export markets.³⁴

6.25 Indeed, in February 2000, BHP announced, in line with market expectations, that prices for the premium coal it sells to Japanese steelmakers would be reduced by

31 Dr Christopher Rawlings, QCT Resources Ltd, *Committee Hansard*, 16 April 1999, p. 492.

32 Karen Gilmour, DFAT, *Committee Hansard*, 15 February 1999, p. 7; Denis Porter, New South Wales Minerals Council, *Committee Hansard*, 14 April 1999, p. 265; Australian Bureau of Statistics, 'Australia Now—A Statistical Profile', International Accounts and Trade, Feature Article—Australia's merchandise trade with Japan, <http://www.statistics.gov.au/australia/w.../bde7ace2081c70e6ca25677b00077c49?OpenDocument> (30 November 1999).

33 Denis Porter, New South Wales Minerals Council, *Committee Hansard*, 14 April 1999, pp. 267–8.

34 James F. Collins, policy adviser of the Steel Manufacturers Association, 48th Annual Meeting of the American Institute for International Steel, 30 November 1999, in *New Steel*, January 2000, <http://www.newsteel.com/news/NW990114.html> (11 February 2000).

about 5% on average. This price reflects the current oversupply of coking coal for internationally traded premium hard coking coal, and it is expected that other major Australian coal suppliers would follow BHP in accepting a similar cut.³⁵

6.26 The drop in demand for coking coal has also dampened plans for new developments in Australia. QCT told the Committee that proposals for a \$470 million investment in new draglines and new coal washing technology had been pulled back and would probably not be more than about \$130 million or \$140 million.³⁶

Thermal coal

6.27 Japan is the world's largest importer of steaming or thermal coal, which is used in power generation. The coking coal market and the steaming coal market are moving in different directions at the moment. With continuing strong demand from Japan, which rose marginally in 1998 by about 1½% to 2%, Australian steaming coal exporters are more confident than their coking coal counterparts.³⁷

6.28 According to QCT Resources Ltd, thermal coal is increasing in demand worldwide at the rate of 6 to 10 million tonnes every six months. The predominant increase is in Asia. Although the demand curve has flattened slightly, there is still strong growth but, unfortunately, no increases in price. The falls in the contract price for steaming coal in 1998 was around 13%. Although disappointed, the NSW Minerals Council was not surprised given the depressed state of the Japanese steel industry.³⁸

6.29 Japan, which depends on more than 80% of its primary energy from imports, has a deliberate policy to diversify its range of power sources to achieve energy security. In relation to coal, the Japanese domestic coal industry is very small and at present, there are only two major underground coal mines in operation. Japan is dependent on overseas supplies for 97% of the coal it uses.³⁹

6.30 The two oil crises during the 1970s exposed the vulnerability of Japan's energy supplies which in turn strengthened its determination to spread its reliance on energy resources over a number of suppliers. Australian coal producers, who provide Japan with over half its coal requirements—about 60% of its steaming coal and about

35 Ben Ready, 'Coal prices forced down 5pc', *Canberra Times*, 8 February 2000, Business, p. 13.

36 Dr Christopher Rawlings, QCT Resources Ltd, *Committee Hansard*, 16 April 1999, p. 492.

37 Denis Porter, New South Wales Minerals Council, *Committee Hansard*, 14 April 1999, pp. 266–7.

38 Dr Christopher Rawlings, QCT Resources Ltd, *Committee Hansard*, 16 April 1999, p. 492; Denis Porter, New South Wales Minerals Council, *Committee Hansard*, 14 April 1999, p. 268.

39 United States Energy Information Administration, May 1999, <http://www.eia.doe.gov/emeu/cabs/japan.html> (16 February 2000); Katsuyoshi Ando, President JCOAL at 24th ICCR Meeting, Wellington, 18 and 19 October 1999, JCOAL Topics, no. 43, November 1999, http://www.jcoal.or.jp/e/Topics_E43.html (9 February 2000).

40% or 50% of its coking coals—sit uneasily with Japan’s policy to diversify its suppliers.⁴⁰ Nonetheless, Australia has established itself as a reliable and stable supplier and Australian coal producers are fully aware of the importance to maintain and enhance this reputation.

6.31 The projections that the Japanese Government has made in determining its energy needs for the future, particularly around the Kyoto debate, indicate that the only way they could fulfil their Kyoto expectations going on to 2010 was to build a large number of nuclear power stations. Nuclear energy provides the largest source of electricity in Japan, generating about 30% of their power. However, to increase nuclear generation substantially is going to be extremely difficult.⁴¹

6.32 Even though the Japanese Government is committed to nuclear power development, several accidents in recent years have aroused public concern and there is mounting unease in Japan about nuclear power generation.⁴² Furthermore, the lead times for construction are long and, according to QCT:

...they cannot even get site approval from the local population. Even if they tacked units onto an existing nuclear power station, they would not produce one-sixth of what is required under their proposed Kyoto proposal.⁴³

6.33 The Department of Industry, Science and Resources also expressed doubts about the Japanese Government’s predictions on future nuclear power generation. It told the Committee that the projections of the Ministry of International Trade and Industry (MITI) for Japan’s energy production are very different from the projections of some of the individual power companies. It surmised that if the MITI projections for the use of nuclear power are not realised, then there is the potential for an increase in coal prices and hopefully increased exports of LNG.⁴⁴ Moreover, if the Japanese

40 Mr Porter supplied the figures of 60% for steaming coal and between 40 and 50% for coking coals. Denis Porter, New South Wales Minerals Council, *Committee Hansard*, 14 April 1999, p. 273.

41 MITI states that nuclear power accounts for 12% of Japan’s energy supply and 34% of electricity supply, MITI, ‘Energy in Japan’, (Overview), <http://www.miti.go.jp/introduction-e/a231201e.html> (16 February 2000). The United States Energy Information Administration, May 1999 states that ‘Of Japan’s total generation of electricity about 69% came from thermal (oil, gas and coal) plants, 20% from nuclear reactors, 10% from hydroelectric stations and 0.3% from geothermal, solar and wind’; United States Energy Information Administration, ‘Japan’, May 1999, <http://www.eia.doe.gov/emeu/cabs/japan.html> (16 February 2000). The Department of Primary Industries and Energy informed the Committee that Japan has undertaken to reduce its greenhouse emissions by 6 per cent from 1999 levels by 2008–12, Department of Primary Industries and Energy, submission no. 31, p. 23.

42 United States Energy Information Administration, May 1999; IEA, ‘Energy Policies of IEA Countries’, Japan, 1999, <http://www.iea.org/new/releases/1999/japan.htm> (16 February 2000); MITI, ‘Energy in Japan’, (Overview), <http://www.miti.go.jp/introduction-e/a231201e.html> (16 February 2000).

43 Dr Christopher Rawlings, QCT Resources Ltd, *Committee Hansard*, 16 April 1999, p. 495. See also for example, ‘Cracks appear in nuke power policy’, *Mainichi Daily News*, 25 July 2000, <http://www.mainichi.companny.jp/english/news/news03.html> (26 July 2000).

44 Craig Burns, Department of Industry, Science and Resources, *Committee Hansard*, 28 May 1999, p. 692.

economy emerges from its recession and there is a continuing growth in energy demand, the Japanese economy will look to electricity produced through coal and natural gas if the nuclear capacity is not there.

6.34 MITI expects coal consumption to grow by 1.2% per year, while utility companies estimate consumption will increase by 2.1% per year. Coal has, therefore, a very significant role to play as an energy source in Japan.⁴⁵ Australia is likely to be a beneficiary of this moderate growth, particularly as it has earned a strong reputation as a dependable supplier and is very aware of the need to improve the industry's environmental image.

6.35 At the centre of Japan's energy policy is the goal to attain the 3Es—energy security; economic growth; and environmental protection.⁴⁶ Australian commodity producers are clearly aware of, and sensitive to, Japanese concerns. QCT believed that cleaner coal from Australia burnt efficiently in modern power stations is far preferable than to have dirty coal coming from somewhere else burnt in open hearths. It told the Committee:

The challenge is that we do not seem to recognise in Australia that even with the Kyoto projections that we managed to negotiate, we have the capability of solving many other pollution problems by using clean Australian coal and new technology.⁴⁷

6.36 The Australian coal industry is serious about reducing greenhouse emissions and recognises that there is significant scope to lift efficiency, lower harmful emissions and at the same time improve coal's image as an environmentally acceptable fuel. Mr Robert Cameron, Chairman, Australian Coal Association, noted that the new generation of combustion technologies can dramatically reduce the SO_x, NO_x and particulate emissions and, through higher thermal efficiency, can reduce CO₂ emissions per unit of electricity generated. He acknowledged that the industry had accepted its responsibility to take 'commercially sensible actions' to minimise their greenhouse emissions and were acting to do so. He mentioned a number of agreements and research projects, such as the Greenhouse Challenge Program, intended to assist the industry in making coal a cleaner fuel.⁴⁸

45 United States Energy Information Administration, 'Japan', May 1999, <http://www.eia.doe.gov/emeu/cabs/japan.html> (16 February 2000); Dr Christopher Rawlings, QCT Resources Ltd, *Committee Hansard*, 16 April 1999, pp. 494–5.

46 MITI, 'Energy in Japan', Overview, <http://www.miti.go.jp/introduction-e/a231201e.html> (16 February 2000)

47 Dr Christopher Rawlings, QCT Resources Ltd, *Committee Hansard*, 16 April 1999, p. 495.

48 Robert Cameron, 'The Australian Coal Industry—Meeting the Challenges', Fifth APEC Coal Flow Seminar, Yokohama, Japan, 4 February 1999, pp. 9–10.

6.37 The Australian Government is also lending assistance to the Australian coal industry in its efforts to produce a cleaner coal. In June 1998, a joint three-year research program involving CSIRO and the Japanese Centre for Coal Utilisation (CCUJ) was established to develop an ‘ultra clean coal’ and to evaluate its commercial viability for Japanese customers. This project was an Australian initiative developed by White Industries and CSIRO’s Division of Energy Technology but will involve prominent Japanese companies, including Mitsubishi Heavy Industries, Idemitsu Kosan and Kyushu Electric Power Company. According to the Minister for Resources and Energy:

Coal is Australia’s most valuable export commodity, and this project is an excellent example of the benefits of fostering quality R&D Start program in the Industry, Science and Tourism portfolio.⁴⁹

6.38 The Committee fully endorses this type of government assistance particularly the joint nature of the project, which brings together both Australian and Japanese interests.

6.39 The debate in Japan about its fuel mix, including the country’s future demand for coal, will continue.⁵⁰ Even so, while there is a range of opportunities for power generation, including coal, nuclear power, natural gas and hydroelectric power, Japan looks on coal as one of its core energy sources among the alternatives to petroleum because of coal’s high level of supply security. Thus, coal has a vital and, for the moment, secure role in Japan’s energy mix.

6.40 Australia, with its rich coal reserves and efforts to make coal a cleaner fuel, is well placed to support Japan in pursuing its energy policy. Nonetheless, the current price for coal is depressed and there is continuing downward pressure on prices. Australia generally secures major long-term minerals and resources contracts with Japan. The market in thermal coal, however, is moving from a long-term contract market into a spot market. QCT explained that coal companies cannot switch on and off production units and they often have spare coal so, when they see a window in the market, they place that spare coal to get cash. A trend is now developing where ‘the pricing of thermal coal, in particular, is being sold at about, or in some cases just less than, the cash cost of production. So we are not seeing a full return—that is on an open and free market on a world basis.’⁵¹

49 See Senator Warwick Parer, Minister for Resources and Energy, Media Release, ‘Joint Australia-Japan Project to Develop Ultra Clean Coal’, 2 June 1998, DPIE 98/322P.

50 See for example Craig Burns, Department of Industry, Science and Resources, *Committee Hansard*, 28 May 1999, p. 693.

51 Dr Christopher Rawlings, QCT Resources Ltd, *Committee Hansard*, 6 April 1999, p. 493.

6.41 This shift is also occurring in the pricing system of steaming coal with customers tending to ‘buy less on annual or multi-year contracts and more on a short-term basis—a spot or tender basis’.⁵²

6.42 While most observers understand Japan’s preoccupation with securing its energy supply and its policy to diversify suppliers so as to enhance energy security, they can see drawbacks for producers such as Australia. Dr Mark Beeson noted that Japan’s approach to diversification of supply means that it is:

...able to play off one producer against the other, so even if you are the cheapest supplier, as a matter of government policy they will encourage the principal buyers of coal in Japan not to put all their eggs in one basket and not to rely too heavily on one country. It is part of a government policy of economic security which they are particularly concerned about and they have very well developed strategies to ensure that they are never in a vulnerable position as far as producers are concerned.⁵³

6.43 It is important for Australia to be able to reassure Japan that it will remain a reliable supplier. Conversely, it is in Japan’s interest to secure a steady and dependable supply. Japan requires energy imports and it is unlikely to discourage proven and reliable suppliers by putting up barriers. Nonetheless, Japan in its own interests will seek to improve ways to meet its energy requirements and will monitor other producers. So, there are possible challenges to Australian producers in terms of whether the Japanese, for example, might encourage natural gas production from the Russian Island of Sakhalin.⁵⁴

6.44 One positive aspect coming out of the present situation, however, is that while coal prices are low, coal is faring well in an extremely competitive energy market. Coal competes in countries such as Japan with other fuels, such as gas and nuclear power, and, because it is competitive, it has held or has even increased its share of the market.⁵⁵ Despite the current depressed market for commodities, Australian producers are looking to the long term. Put bluntly, QCT summed up the present approach taken by coal exporters in Australia:

When you look at the merchandising market and the commodities market in Australia, none of us feel too positive. We are really battenning down the hatches to hang in there. Everything we are doing at the moment is not

52 Denis Porter, New South Wales, Minerals Council, *Committee Hansard*, 14 April 1999, p. 264.

53 Dr Mark Beeson, *Committee Hansard*, 16 April 1999, p. 476. See Chapter 7, paras 7.70–7.77 for more information on how sale prices are negotiated between Japanese customers and Australian commodities producers.

54 Denis Porter, New South Wales Minerals Council, *Committee Hansard*, 14 April 1999, p. 275.

55 Denis Porter, New South Wales Minerals Council, *Committee Hansard*, 14 April 1999, p. 265.

about new investment; it is about trying to stay alive and keep the businesses running until we do see a turnaround.⁵⁶

Iron ore

6.45 Iron ore is one of Australia's major export commodities. It contributes about 4% to 5% of total Australian exports and in 1998–99 raised revenue of \$3.8 billion. Japan has a long-standing interest in importing Australian iron ore and has established itself as a most important market for this Australian commodity. In 1992–93, Japan took 49% of Australia's iron ore exports down from 54% in 1989. In 1995–96 this dropped to 45% and remained steady until it fell further to 44% for 1997–98 before recovering to reach 46% in 1998–99. In 1999, Japan's share of Australia's total iron ore exports stood at 46.7%, although the overall value of the iron ore had fallen. Despite these variations in the export share, Japan remains Australia's major market for iron ore followed by China and the Republic of Korea, which took 20% and 15% respectively of Australian total iron ore exports in 1998. The value of iron ore exported to Japan fell during the early half of the 1990s but, overall, has grown modestly from \$1.122 billion in 1989 to \$1.789 billion in 1998.⁵⁷

6.46 According to the Australian Bureau of Statistics, the fluctuations in the value of iron ore exports to Japan over the last decade were caused by changing contract prices, reflecting shifts in overall global supply and demand and increasing competition for market share, notably from Brazil. Nonetheless, Japan still looks predominantly to Australia for its supply of iron ore and, more recently, Australia's market share into Japan has begun to improve. In 1998, Australia provided 51% of Japan's iron ore imports, an increase from 44% in 1989.⁵⁸ In 1999, this share fell back marginally to 49.6%.⁵⁹

6.47 The falling demand in Japan for commodities, such as coal and iron ore, has placed downward pressure on prices. According to Hamersley Iron Ltd, Australian

56 Dr Christopher Rawlings, QCT Resources Ltd, *Committee Hansard*, 16 April 1999, p. 505.

57 *Commonwealth Year Book*, no. 7—1995, p. 774; no. 78—1996, p. 680; no. 79—1997, p. 707; no. 80—1998, p. 775; no. 81—1999, p. 745; no. 82—2000, p. 791. See also Australian Bureau of Statistics, 'Australia Now—A Statistical Profile', International Accounts and Trade, Feature Article—Australia's merchandise trade with Japan, <http://www.statistics.gov.Australia/w.../bde7ace2081c70e6ca25677b00077c49?OpenDocumen> (30 November 1999).

58 Australian Bureau of Statistics, 'Australia Now—A Statistical Profile', International Accounts and Trade, Feature Article—Australia's merchandise trade with Japan, <http://www.statistics.gov.Australia/w.../bde7ace2081c70e6ca25677b00077c49?OpenDocumen> (30 November 1999) (page 9 of 15). Hamersley told the Committee that Australia's market share in Japan has, over the last five years, recovered from roughly 48% to 53% to 54%, Philip Mitchell, General Manager, Strategic Marketing, Hamersley Iron Pty Ltd, *Committee Hansard*, 24 February 1999, p. 102.

59 Additional information supplied to the Committee by DFAT, 18 May 2000.

suppliers do not enjoy the dominant position they once did in coal and iron ore.⁶⁰ During lengthy negotiations with Japanese steelmakers in February 1999, Australian producers argued that a large price cut in iron ore would curtail new investment. Even so, Hamersley Iron had to settle for double-digit reductions in price for iron ore. This agreement effectively set the price for iron ore at 11% less than for the previous year.⁶¹ As with coal, this reduction in price was disappointing but anticipated given the weakened state of the Japanese steel industry.⁶² Nippon Steel explained the fall in 1999 prices:

...the harsh circumstances besieging the Japanese steel industry along with an expected decline in demand from other Asian nations have led to the settlement at a marked decrease in the price of both iron ore and coking coal.⁶³

6.48 Clearly, the depressed steel market is having an effect on Australian exporters but it is occurring through price rather than through volumes of exports.⁶⁴ Hamersley Iron Ltd explained that iron ore is basically priced pursuant to the rules applying to most commodities. The price is set at the point where the marginal producer is producing his marginal tonne.⁶⁵ Iron ore and LNG are sold on long-term contract to Japan. However, there is some flexibility in the volumes of those commodities which Japan takes—in the order of 10% to 15% within those contracts. Because the volumes are largely set within the contract, the adjustment to changes in demand tends to occur through price rather than volume. This arrangement accounts for all three major iron ore producers in Australia accepting cuts in their prices of between 11% and 13% in 1999.⁶⁶

6.49 Much of the steel produced in Japan is destined for export. Indeed, DFAT noted that the expected and anticipated price and volume cuts agreed to in on-going

60 Philip Mitchell, General Manager, Strategic Marketing, Hamersley Iron Pty Ltd, *Committee Hansard*, 24 February 1999, p. 91.

61 Prices were down 11% for fine ore, 10.2% for lump ore and 7.5% for lump premium, AME Mineral Economics, *Monthly Outlooks, Iron Ore*, February 1999.

62 Denis Porter, New South Wales Minerals Council, *Committee Hansard*, 14 April 1999, p. 268.

63 Nippon Steel, Business, Steel, <http://www.nsc.co.jp/english/business/steel.html> (15 February 2000). See also Timothy Marney, Treasury Department of Western Australia, *Committee Hansard*, 25 February 1999, p. 160.

64 Timothy Marney, Treasury Department of Western Australia, *Committee Hansard*, 25 February 1999, p. 160.

65 Philip Mitchell, General Manager, Strategic Marketing, Hamersley Iron Pty Ltd, *Committee Hansard*, 24 February 1999, p. 99 and Timothy Marney, Treasury Department of Western Australia, *Committee Hansard*, 25 February 1999, p. 160.

66 See chapter 7, paras 7.70–7.75 for information on recent developments in the relationship between Australian iron ore producers and their Japanese customers.

negotiations reflects the global downturn particularly in steel as well as the Japanese recession.⁶⁷

6.50 According to QCT, the Japanese steel industry in 1998 achieved 102 million tonnes of crude steel production—hitting an historical low for the past 27 years—and predicted further falls in production. This drop in production translates almost directly into reductions in demand for iron ore. QCT had doubts about the Japanese estimates for production levels for the near future and feared further reductions would affect significantly the supply-demand balance and the price structure.⁶⁸

6.51 Because of a stagnant domestic economy and slow growth in regional markets, as well as tensions arising elsewhere because of excessive exports, Japan's outlook for 2000 is for the production of crude steel to remain flat with only a slight increase in production.⁶⁹ Up to this time, Australian commodities have held up quite well but the future, while not bright, shows some glimmer of hope. In February 2000, Robe River Iron Associates ratified a 4.35% increase for sinter fines with Japanese steel mills. This increase, described by a company spokesman as 'very satisfactory in the context of expectations late last year', suggested a 'strengthening in the steel market'. Moreover, it was a further recognition 'of Robe's consistent ability to deliver product on grade and on time'. Industry officials expected to see similar or slightly larger increases for lump ore.⁷⁰

6.52 Indeed, in March this year, BHP negotiated a price rise for both fines and lump ore. These new prices represent an average increase of over 5% and, though encouraging, still reflect 'Japan's difficult economic situation'. President of BHP Minerals, Mr Ron McNeilly, stated, 'The result, while positive, only allows us to recoup less than half the price cuts from last year, maintaining the pressure on iron ore producers to reduce costs and improve efficiencies to maximise returns on investment.'⁷¹

67 Karen Gilmour, DFAT, *Committee Hansard*, 15 February 1999, p. 7.

68 Dr Christopher Rawlings, QCT Resources Ltd, *Committee Hansard*, 16 April 1999, pp. 489–90. The US Geological Survey, *Mineral Commodities Summaries*, January 1999, provided the following statistics for raw steel production in Japan—1997: 105 million tonnes and in 1998: 95.1 million tonnes. DKR *Economic Report*, vol. 3, no. 2, 15 February 2000, p. 12.

69 *Metals News*, 15 July 1999, <http://www.manufacturing.net/magazine/purchasing/archives/1999/pur...071mnews.ht> (2 February 2000). See chapter 8 for a more detailed explanation about trade tensions arising from Japan's exports of steel.

70 North Ltd, Media Release, 29 February 2000, <http://www.north.com.au/news-releases/rel-2000022900.html> (7 March 2000); *Financial Review*, 4–5 March 2000, p. 12.

71 BHP, Press Release, 29 March 2000, http://www.bhp.com.au/press/bhp_press/data/20000329a.htm (30 March 2000). See also Ian Howarth, 'Strong Asian demand for iron ore steels Rio's quarter', *Australian Financial Review*, 29–30 April 2000, Business, p. 15.

6.53 The Australian iron ore sector must work within its own set of limitations and, as pointed out by Hamersley Iron, Australia has limited scope to stimulate demand for commodity exports. Nonetheless, it noted that Australia, despite the erosion of its position as a supplier, does have the capacity to influence supply. Even so, it observed:

In present circumstances, stimulating the supply of iron ore would only drive down the price of iron ore further. If you accept a philosophy that the Japanese buyers will always strategically constrain themselves to taking no more than 50 to 60 per cent of their iron ore supplies from Australia...then stimulating supply of further iron ore in this country will reduce Australian export revenues, because you push down the price but you do not actually push up the quantity.⁷²

6.54 Given that Australia's leverage is limited, Australia's national interest lies in doing whatever it can to prevent further deterioration in key markets. Maintaining Australia's reputation as a steadfast supplier is most important. Mr Timothy Marney, Director, Economic Policy, Treasury Department of Western Australia, underlined this point. He submitted that Australia's standing:

...has insulated us to some extent in that steel production has fallen in the order of 10 per cent yet our iron ore exports to Japan have continued to increase.⁷³

In other words, Australian producers have not suffered cuts in volumes of trade with Japan to the same extent as its competitors.

6.55 BHP noted the need to minimise costs and remove inefficiencies from the industry. Hamersley Iron agreed that this was a priority and pointed out that it was successfully reducing costs. It suggested that Australia continue to support the recovery efforts of Asian economies and maintain its pressure on Japan to accelerate domestic reform.⁷⁴

6.56 It was also put to the Committee that in a highly competitive global market, domestic costs should be kept to a minimum. It was suggested, for example, that rail reform and removal of barriers to competition in domestic markets would cut business costs and help create a dynamic business environment, which would encourage

72 Philip Mitchell, General Manager, Strategic Marketing, Hamersley Iron Pty Ltd, *Committee Hansard*, 24 February 1999, p. 92.

73 Timothy Marney, Treasury Department of Western Australia, *Committee Hansard*, 25 February 1999, p. 160. See also Department of the Treasury, submission no. 63, p. 28.

74 Philip Mitchell, General Manager, Strategic Marketing, Hamersley Iron Pty Ltd, *Committee Hansard*, 24 February 1999, pp. 91 and 102.

Australians to embark on new ventures. Such measures would also benefit the whole community.⁷⁵

Aluminium

6.57 Aluminium is one of Australia's top five export earners and accounts for nearly 4% of Australia's total exports.⁷⁶ Japan is Australia's principal market for aluminium. In 1989, exports of aluminium to Japan were valued at \$1.4 billion which accounted for 11% of Australia's total exports to Japan and 55% of Australia's total exports of aluminium. By 1998, exports of aluminium to Japan had fallen 11% in value to \$1.251 billion. This represented 7% of Australia's total exports to Japan and 37% of Australia's total exports of aluminium. In 1999, the value of aluminium exports to Japan fell slightly and accounted for 33.4% of Australia's export market in aluminium.⁷⁷

6.58 Falls in the world aluminium price, a reduced Japanese demand and fierce competition from the United States, Brazil and the USSR were responsible for the substantial decline in the value of aluminium exports to Japan, especially during the early 1990s. Despite the overall decline in the value of exports, Australia remains one of Japan's major suppliers of aluminium. In volume terms, 24% of Japan's aluminium imports came from Australia in 1989, a slump followed with the share falling to between 15% and 17%, which rebounded in 1998 to 24% before falling back to 19.4% in 1999.⁷⁸

6.59 According to ABARE, the outlook for Japanese purchases of Australian aluminium in the medium term will depend on the extent of any return to growth in other markets, particularly in Asia. Total Japanese imports of aluminium are expected to rise relatively slowly.⁷⁹

Liquefied Natural Gas (LNG)

6.60 Since exports of LNG from the North West Shelf began in 1989, gas has gained in importance as an export earner for Australia. Between 1989 and 1994, exports of natural gas increased by 813%, from \$112 million to \$1.023 billion. By

75 For example, see comments by Mr Simon Wensley, Hamersley Iron Pty Ltd, *Committee Hansard*, 24 February 1999, p. 89.

76 Market Information and Analysis Unit, Department of Foreign Affairs and Trade, *Composition of Trade, 1998*, June 1999, pp. 13, 32.

77 Additional information supplied to the Committee by DFAT, 18 May 2000.

78 Australian Bureau of Statistics, 'Australia Now—A Statistical Profile', International Accounts and Trade, Feature Article—Australia's merchandise trade with Japan, <http://www.statistics.gov.au/w.../bde7ace2081c70e6ca25677b00077c49?OpenDocumen> (30 November 1999) (page 11 of 15). Additional information supplied to the Committee by DFAT, 18 May 2000.

79 ABARE, submission no. 21, p. 21.

1994, Japan was Australia's most important market for natural gas which accounted for 6% of total exports to Japan. Since August 1995, Australia's gas exports have come under confidentiality restrictions.⁸⁰

6.61 In 1999, Woodside, a participant in and operator of the North West Shelf Venture, announced that each year they sell 7.5 million tonnes of LNG worth more than \$1.5 billion in export income and that all but a few cargoes are sold under long-term contracts to customers in Japan. The North West Shelf Venture currently supplies, under long-term contracts, about 15% of Japan's LNG needs.⁸¹

6.62 Japan is a substantial joint venture partner in the operations in Western Australia in the North West Shelf. It is also heavily involved in developing infrastructure at the receiving end. The Treasury Department of Western Australia noted that the handling of LNG represents 'quite a significant investment' for the Japanese companies. It acknowledged this valuable and very significant contribution made by Japanese investment to LNG projects in Australia.⁸² Woodside informed the Committee:

We have eight Japanese buyers—five power companies and three gas companies. They are joined together in a consortium to give us long-term contracts, 20-year contracts for the sale of the LNG in order that we can invest the capital. The Japanese offtake was contracted at maximum and minimum rates and fortunately the Japanese customers took higher than their minimum rates right from the very start so that our build-up was faster than we had anticipated and we have had very strong support. That has continued even in these very difficult times and we are very conscious of the role the customers have played in our viability.⁸³

80 Australian Bureau of Statistics, 'Australia Now—A Statistical Profile', International Accounts and Trade, Feature Article—Australia's merchandise trade with Japan, <http://www.statistics.gov.au/w.../bde7ace2081c70e6ca25677b00077c49?OpenDocumen> (30 November 1999) (page 8 of 15). The term confidentiality as explained in footnote 20 states that the Australian Bureau of Statistics suppresses some detailed trade statistics for confidentiality reasons and included commodities such as sugar, rice, wheat and LNG.

81 Woodside, 'Business and Finance News', 25 August 1999, <http://www.woodside.competition.Australia/business/News.cfm?ID=19990920115240> (18 February 2000). DFAT showed that, in 1999, Australia's share of Japan's LNG imports was 14.6%, additional information supplied to the Committee by DFAT, 18 May 2000. Erica Smyth, told the Committee that LNG generates about \$3 billion worth of annual export income. *Committee Hansard*, 25 February 1999, p. 205.

82 The six equal participants in the North West Shelf Venture are: Woodside Energy Ltd (operator); BHP Petroleum (North West Shelf) Pty Ltd; BP Developments Australia Pty Ltd; Chevron Asiatic Limited; Japan Australia LNG (MIMI) Pty Ltd; and Shell Development (Australia) Proprietary Limited. See also Erica Smyth, Woodside Energy Ltd, *Committee Hansard*, 25 February 1999, p. 211 and Timothy Marney, Treasury Department of Western Australia, *Committee Hansard*, 25 February 1999, p. 161.

83 Erica Smyth, Woodside Energy Ltd, *Committee Hansard*, 25 February 1999, p. 207.

6.63 On a cost per unit, gas is not cheap because of the capital involved in producing LNG, its transportation and its receipt and storage at the other end. Nonetheless, Australian gas producers are able to help Japan achieve two of the most important goals underlying its energy policy—to secure a stable supply of energy and to protect the environment.

6.64 Australia stands on its record as a reliable supplier, a reputation supported by a very stable and predictable political climate.⁸⁴ In August 1999, the North West Shelf Venture celebrated its 1,000th cargo of LNG to Japan. Woodside announced this milestone as a ‘tribute to the excellent relationship which has developed over the past 10 years between the North West Shelf Joint Venture and the eight Japanese power and gas utilities which formed the foundation buyers’ consortium’. Reliability as a supplier was fundamental to this relationship with the Venture proudly proclaiming that in the 10 years of LNG exports, it had never missed a cargo.⁸⁵

6.65 Gas is also, according to Woodside, the greenest hydrocarbon and Australian gas can make a substantial contribution to the reduction of air pollution and ‘greenhouse emissions problems in the region’s major population centres by displacing coal and oil as energy sources’.⁸⁶ Thus, despite its relative high cost, LNG is a clean fuel and the LNG industry as a whole is very reliable. Clearly, Australia, as a major producer of LNG, has the potential to play a greater role in helping Japan meet its energy needs.

6.66 As noted earlier, if the MITI projections for the use of nuclear power are not realised, there is potential for an increase in coal prices and increased exports of LNG. The future of some of the significant LNG projects in Australia, particularly the North-West Shelf project, hinge on sales from increased LNG usage in Japan.⁸⁷

6.67 Stagnation of the Japanese economy is a major concern because Japan is the largest LNG buyer in South East Asia by a long measure. The dampened demand for commodities, such as LNG, influence investment and development. Woodside pointed out that the drop in demand for commodities had led to a review of investment in new developments for the time being. The contraction of the economy in Japan has slowed down Woodside’s anticipated schedule for expansion.⁸⁸

84 Erica Smyth, Woodside Energy Ltd, *Committee Hansard*, 25 February 1999, p. 205.

85 Woodside, ‘Business and Finance News’, 25 August 1999, <http://www.woodside.competition.au/business/News.cfm?ID=19990920115240> (18 February 2000).

86 Woodside, ‘Business and Finance News’, 25 August 1999, <http://www.woodside.competition.au/business/News.cfm?ID=19990920115240> (18 February 2000).

87 Barry Jones, Department of Industry, Science and Resources, *Committee Hansard*, 28 May 1999, p. 692.

88 Erica Smyth, Woodside, Energy Ltd, *Committee Hansard*, 25 February 1999, p. 206.

6.68 Even so, the overall tightening of economic activity has provided incentive for the industry to increase its competitiveness by reducing operating costs. Woodside told the Committee that it is undertaking a major program of capital cost reductions and is working closely with Japanese buyers to try to streamline their project so that it melds with their needs.⁸⁹

6.69 In responding to suggestions about major infrastructure developments to assist Australia's export industry, QCT Resources was positive. It considered that the challenge was in finding finance for such large-scale schemes and that Australia should be doing something like that once every five years. It noted Australia's natural competitive advantages—cheap energy, good raw materials and a very good, innovative and productive Australian work force. In brief, QCT stated, 'we do not use them'.⁹⁰

6.70 The Committee is aware that industries in the mining sector have built up over the years a reputation as dependable and reliable suppliers—a standing that holds Australia in good stead with its Japanese customers, especially during this time of economic downturn. The Committee believes that the Australian Government and industry should continue to emphasise Australia's reputation as a competitive and reliable resource supplier in negotiations with Japan.

6.71 The Committee acknowledges the attempts of Australian industry and the Australian Government to work toward more environmentally sound means of producing their product or producing a product that will minimise harm to the environment. This is particularly so in research being conducted to produce cleaner coal. This is an area that requires research and education and one in which the Australian Government should take a lead.

Recommendation

The Committee recommends that the Australian Government encourage further joint research and development between Australia and Japan in the area of resource development and environmental protection.

Agricultural exports to Japan

Overview of Australia's agricultural exports to Japan

6.72 The complementarity that has been an enduring feature of the relationship between Australia and Japan in the mineral and energy sector also extends into

89 Erica Smyth, Woodside, Energy Ltd, *Committee Hansard*, 25 February 1999, pp. 206–7.

90 Dr Christopher Rawlings, QCT Resources Ltd, *Committee Hansard*, 16 April 1999, pp. 505–6.

agriculture. Japan is a resource poor but capital rich country while Australia, as a resource endowed country, is able to complement Japan's needs for raw materials and foodstuffs.

6.73 Japan's concern over its high dependency on imports to satisfy demand in minerals and energy extends to its policy on food supply. Japan depends on three countries—the United States, Canada and Australia—for more than 80% of major farm products, such as grains.⁹¹ The Japanese people hold food self-sufficiency as an indispensable part of their national security. According to the results of a recent public opinion poll, 80% of Japanese are concerned about the future food supply and 70% are willing to pay an additional reasonable cost for food so as to secure their food supply in the long run.⁹²

6.74 A report by the Japanese Investigative Council on Basic Problems Concerning Food, Agriculture, and Rural Areas highlighted Japan's heavy dependency on outside producers to feed its people:

Japan's food-self-sufficiency ratio has been on a continual decline. Japan's food self-sufficiency ratio was 42% in terms of calorie basis, or 29% in terms of grain in 1996, the lowest among major industrialized countries. The grain self-sufficiency ratio is the 135th highest among the world's 178 economies. In other words, Japan depends on farm imports for much of its food supply. In order to maintain its current diet, Japan depends on overseas farmland that is 2.4 times as large as the domestic one in a sense.⁹³

6.75 Governments, such as Japan's, which wish to protect their local products from imported goods choose from a range of trade barriers such as tariffs, quotas or a licensing system to keep imports at desired levels. Governments may also use various subsidies to domestic producers to give their home product a competitive edge. There is also a minefield of regulations governing matters such as quarantine and the distribution of products that may be used to limit or control foreign imports.

6.76 Food industries face a raft of regulations whenever they sell into the Japanese market. With beef, the Japanese apply a quota and tariff system which has been eased in recent years. Rice is subject to quotas and tariffs and sugar is confronted by a complicated system of licences, duties and levies. For many years, Australian wheat has enjoyed a secure market share of the Japanese market.

91 The Ministry of Agriculture, Forestry and Fisheries, Annual Report on Japanese Agriculture FY1998 (Summary) (Provisional translation).

92 Keiji Ohga, World Food Security and Agricultural Trade, paper presented in the OECD Workshop on Emerging Issues in Agriculture, Paris, October 1998.

93 The Report submitted to the Prime Minister by the Investigative Council on Basic Problems Concerning Food, Agriculture, and Rural Areas, September 1998, <http://www.maff.go.jp/ekihon/Report.html> (3 May 1999). See also Keiji Ohga, World Food Security and Agricultural Trade, paper presented in the OECD Workshop on Emerging Issues in Agriculture, Paris, October 1998.

Beef

6.77 Beef is one of Australia's major export commodities contributing to between 4% and 5% of Australia's total exports. Over the last decade, Japan has become a vital part of that export market. The value of Australian beef exported to Japan has almost doubled from \$773 million in 1989 to over \$1.3 billion in 1998 and almost \$1.4 billion in 1999. In 1989, Japan took 37% of Australia's beef exports; in 1992–93, 42%; which rose to 55% in 1994–95 before falling back to 47% in 1998 and 46.3% in 1999.⁹⁴

6.78 The significant rise in beef exported to Japan during the early 1990s can be attributed to a gradual liberalisation of beef imports since 1988–89, with the removal of quotas and the lowering of tariffs from 70% to 50%. Prior to that, Australian access was through essentially a quota system.⁹⁵ Factors, such as changing tastes and shifts in exchange rates, have also contributed to increases in demand for beef. According to the Australian Bureau of Statistics:

The sharp rise in beef exports to Japan up until 1994 reflected the combined effect of increasing consumer demand, gradual tariff reductions and the continued strength of the yen. The downturn in exports in 1995 and 1996 was due, in large measure, to an appreciating Australian dollar and growing competition from the United States of America. Between 1996 and 1998, the value of beef exports to Japan rose again due to slightly lower Japanese domestic production, a favourable exchange rate and higher US beef prices.⁹⁶

6.79 Despite the recent rise in the value of beef exported to Japan, the Japanese recession has dampened consumer demand and Japan's share of Australia's beef exports has remained flat though nonetheless substantial at around 47%.⁹⁷ The future for Australian beef exporters to Japan looks promising with the predicted downturn in

94 *Year Book Australia*, no. 77—1995, p.774, no. 78—1996, p. 680. Market Information and Analysis Unit, Department of Foreign Affairs and Trade, *Composition of Trade, 1998*, June 1999, p. 203. Australian Bureau of Statistics, 'Australia Now—A Statistical Profile', International Accounts and Trade, Feature Article—Australia's merchandise trade with Japan, <http://www.statistics.gov.Australia/with.../bde7ace2081c70e6ca25677b00077c49?OpenDocument> (30 November 1999) (page 10 of 15).

95 Dr Peter Barnard, Meat and Livestock Australia, *Committee Hansard*, 15 April 1999, pp. 378 and 383.

96 Australian Bureau of Statistics, 'Australia Now—A Statistical Profile', International Accounts and Trade, Feature Article—Australia's merchandise trade with Japan, <http://www.statistics.gov.Australia/with.../bde7ace2081c70e6ca25677b00077c49?OpenDocument> (30 November 1999) (page 10 of 15).

97 Meat and Livestock Australia, *Committee Hansard*, 15 April 1999, pp. 378 and 381; and Australian Bureau of Statistics, 'Australia Now—A Statistical Profile', International Accounts and Trade, Feature Article—Australia's merchandise trade with Japan, <http://www.statistics.gov.Australia/with.../bde7ace2081c70e6ca25677b00077c49?OpenDocument> 30 November 1999 (page 10 of 15).

the United States' cattle cycle. The Meat and Livestock Association (MLA) suggested that Australia's market share will be either steady or increase further over the next four or five years.⁹⁸ In 1999, Australia held a substantial share of 37.8% of Japanese beef imports.⁹⁹

6.80 Notwithstanding the reduction in import quotas imposed by Japan on beef, solid impediments to trade remain. The MLA told the Committee that at the end of the Uruguay Round, beef tariffs into Japan will still be at 38.5% and the cost of that tariff to the Australian beef industry has been estimated at about \$200 million a year. It explained further:

Moreover, there are snap back provisions under which the tariff can revert back to 50 per cent if beef imports into Japan increase by more than 17 per cent. So those snap back provisions also create considerable uncertainty in the trade.¹⁰⁰

6.81 Accepting Japan's agreement to reduce the tariff to 38.5% by the year 2001, the MLA urged Australia to continue to promote agriculture as part of trade reform in regional trade agreements such as APEC, as well as in multilateral trade agreements. It stressed that the further reduction of tariffs must be of primary importance in the millennium round of the WTO. Put simply:

Australia needs to do all it can to pressure countries like Japan to reduce impediments to agricultural trade...we must do all in our power to pressure for reductions in tariffs and in trade impediments generally.¹⁰¹

6.82 In turning to the distribution system in Japan, the MLA noted that the system had undergone some rationalisation, but nonetheless regarded the system as 'probably still unduly complex'. The MLA's main concern, however, was with the tariff barriers rather than the non-tariff barriers.¹⁰² The question of access and import tariffs remains a priority for Australian beef exporters and is one that they will continue to pursue. According to the Australian Meat Council, it will join with all sectors of government and industry to try to achieve better access and lower tariffs.¹⁰³

6.83 Despite the obstacles confronting beef exporters, Australia has made considerable inroads into the beef market in Japan. The Australian beef industry is

98 Dr Peter Barnard, Meat and Livestock Australia, *Committee Hansard*, 15 April 1999, p. 379. The Meat and Livestock Association is a new company and supersedes the Australian Meat and Livestock Corporation and the Meat Research Corporation.

99 Additional information supplied to the Committee by DFAT, 18 May 2000.

100 Dr Peter Barnard, Meat and Livestock Australia, *Committee Hansard*, 15 April 1999, p. 380.

101 Dr Peter Barnard, Meat and Livestock Australia, *Committee Hansard*, 15 April 1999, p. 385.

102 Dr Peter Barnard, Meat and Livestock Australia, *Committee Hansard*, 15 April 1999, p. 384.

103 Stephen Martyn, Australian Meat Council, *Committee Hansard*, 15 April 1999, p. 381.

very aware and sensitive to the particular concerns of the Japanese consumer, particularly safety and quality matters, and has deliberately cultivated a good understanding with its customers. Again, the industry keeps in close touch with its customers' needs and changing tastes and works very closely with Japanese beef buyers. It invests much time, effort and money into consolidating the long-term relationships that are fundamental to maintaining market and commercial access into the Japanese market.

Rice

6.84 Although rice is not one of Australia's major exports to Japan, it nonetheless demonstrates some of the difficulties experienced by Australian exporters keen to improve access to the Japanese market. It also provides an interesting insight into Japan's strong concern about food self-sufficiency.

6.85 Rice has been the staple food of the Japanese for over 200 years. It is an integral part of Japanese culture and social structure and has a special significance for the Japanese people. As a rice-based culture, many Japanese feel strongly that Japan should be completely self-sufficient in this traditional staple food and even in the face of mounting international pressure, Japan has consistently baulked at opening its rice market to foreign competition.¹⁰⁴

6.86 Until 1995, Japan maintained an effective ban on rice imports. The agricultural ministry, through the Japan Food Agency, has the exclusive right to conduct trade in rice. Japan imported rice only when domestic production fell short of domestic demand as was the case in 1993 when unseasonable weather reduced the local rice crop. In reaching the Uruguay Round Agreement on Agriculture in 1995, however, Japan opted to import foreign rice under a minimum access quota system rather than adopt a tariffication of rice scheme. This agreement meant that Japan was required to import rice equal to a specified percentage of its annual domestic rice consumption. This percentage was to increase at an annual rate of 0.8% over the six year period from 4% in 1995 to 8% in 2000.¹⁰⁵

6.87 Although Japan is opening its markets to rice imports, the process of buying and selling rice in Japan is complicated and is closely regulated through the Japan Food Agency. The minimum market access quota is divided into two categories, ordinary quota and special quota or simultaneous buy and sell (SBS). The ordinary or

104 See Embassy of Japan to the United States, '“Rice Tariffication” Q&A' <http://www.embjapan.org/sf/rice.htm> (25 February 2000); David Askew, *Committee Hansard*, 17 May 1999, p. 544; Denis Gregory, 'Ricegrowers boil at Tariff', *Sun-Herald*, 2 May 1999, p. 71. See also Margaret Smee, submission no. 1, pp. 1–2.

105 Murata Yasuo, 'Working Around Rice Imports', *Japan Quarterly*, April-June 1999, p. 10; Shinichi Shogenji, 'Towards a Balanced Policy Framework for Food, Agriculture and Rural Areas: The case of Japan', http://www2.hasaii.education/apfat/PP09/iep_p09.htm (19 August 1999); Daily Summary of Japanese press, 14 December 1998.

regular minimum access is government business conducted by the Food Agency to add to the government's strategic stock holdings. The SBS is a more commercial transaction conducted by licensed trading houses through the Food Agency. Commencing with imports during the 1993 emergency period, the Ricegrowers Co-operative, Australia's dominant producer and exporter of rice, has successfully exported to Japan under both minimum access and SBS import mechanisms.

6.88 In the first SBS tender, in Japanese financial year 1995, Australia supplied 85,000 tonnes under minimum access and around 2,000 tonnes under SBS. By the end of the 1998 financial year, the Ricegrowers Co-operative had supplied to Japan around 350,000 tonnes of rice, worth on average around \$A240 million since 1995–96. In financial year 1998–99, Australia supplied Japan with 16% of its imported rice, over 14,000 tonnes through SBS and 87,000 under regular minimum assessment.¹⁰⁶ In 1999, Australia made up 18.1% of Japan's imported rice.

6.89 In December 1998, Japan announced that it would lower annual market access increases in the 1999–2000 periods from 0.8% of base consumption to 0.4% from 1 April 1999. These smaller increases set the import quota in 1999 at 644,000 tonnes instead of 682,000 tonnes, and in the year 2000 the quota will be 682,000 tonnes instead of 758,000 tonnes. Until another agreement is made, Japan's annual minimum access after the year 2000 will remain at 682,000 tonnes.¹⁰⁷

6.90 As part of this new import arrangement, the government now applies a tariff of ¥351.17 for each kilogram of imported rice that comes in above the minimum access level. This equates to around \$A4.47 per kilogram in 1999. This tariff will be reduced in April 2000 to ¥341 per kilogram, which is around \$A4.34 per kilo.¹⁰⁸

6.91 There is a clear suggestion that the imposition of such a high level of tariff is designed to thwart any further increases in rice imports into Japan. Many regard this fixed tariff of ¥351.17 per kilo on imported rice as prohibitive—intended to penalise foreign rice in the domestic market.¹⁰⁹ The Ricegrowers Co-operative argued:

Even a reduction in the year 2000 to ¥341 per kilo will not be enough to stimulate overquota trade. At a tariff level of ¥351 per kilo, Japanese buyers are unlikely to import any rice other than the premium outside the minimum access amount. With a very strong yen, the Australian dollar may be

106 In 1998–99, the US supplied Japan with 48% of its rice imports and Thailand with 21%, Australia had a 16% share and China a 11% share. *FAS Outline*, 'Foreign Countries' Policies and Programs', <http://www.fas.usda.gov/grain/circular/1999/99-02/dtricks.htm> (24 February 2000). See also Milton Bazley, Ricegrowers Co-operative Ltd, *Committee Hansard*, 17 May 1999, p. 531.

107 Milton Bazley, Ricegrowers Co-operative Ltd, *Committee Hansard*, 17 May 1999, pp. 531–2.

108 Milton Bazley, Ricegrowers Co-operative Ltd, *Committee Hansard*, 17 May 1999, p. 2.

109 Dr Aurelia George Mulgan, *Committee Hansard*, 28 May 1999, p. 680; Milton Bazley, Ricegrowers Co-operative Ltd, *Committee Hansard*, 17 May 1999, pp. 531–2.

competitive with top quality Japanese varieties. But regardless of the exchange rate, prices for standard quality Australian imports, including the ¥351 per kilo tariff, would not be competitive with domestic Japanese rice.¹¹⁰

6.92 Undoubtedly, the high tariffs are a formidable trade barrier. DFAT argued that the rice tariffication proposal would probably mean that while Australia could maintain its current level of rice exported to Japan, the tariff would cut down the potential for future growth.¹¹¹ Even so, the Ricegrowers Co-operative accepted that tariffication was a step in the right direction.¹¹²

6.93 At first, Australia objected strongly to the imposition of such a high tariff and, while welcoming Japan's intention to cease to apply special treatment for rice, expressed concern about the methodology used to calculate the rate of tariff which it argued was unfair.¹¹³ In March 1999, the Australian Government lodged a formal objection in the WTO. Yet one month later, it reversed its position, drawing criticism from the Federal Opposition for its inconsistency. The following explanation appeared in an article from *Asialine*:

...following a reappraisal of the technical aspects of the issue and in view of subsequent commercial developments, Australia decided to withdraw its objection and pursue its concerns on the level of tariffs in the WTO negotiations in agriculture, which are scheduled to commence at the end of 1999.¹¹⁴

6.94 Although rice consumption is declining in Japan, it will remain an important staple in the Japanese diet. The Japanese are becoming much more westernised but they are also becoming much more sensitive to health and the value of rice in the diet. Since the opening up of wheat and the introduction of wheat-based products, such as bread and noodles, to Japan, people have switched to those products because they are generally cheaper than rice. In light of the change in tastes and the price differentials between rice and alternative foods, the current pricing arrangements and quota systems do not encourage increased consumption.

110 Milton Bazley, Ricegrowers Co-operative Ltd, *Committee Hansard*, 17 May 1999, p. 532.

111 Colin Heseltine, DFAT, *Committee Hansard*, 15 February 1999, p. 12.

112 Milton Bazley, Ricegrowers Co-operative Ltd, *Committee Hansard*, 17 May 1999, p. 532.

113 The Hon Tim Fischer, MP, Deputy Prime Minister and Minister for Trade, Media Release, 'WTO Rice Tarrification Response', 19 March 1999 and WTO Summary Report of the Meeting held 12–26 March 1999, G/AG/R/18. The level of tariff has been calculated by comparing the value of imports in the Uruguay Round base period, 1986–88, with the value of the local product over the same period. At the time of the base period being set, Japan was only importing lower quality broken rice, particularly from Thailand, for industrial use.

114 Country Information, Japan, 'Australia's Rice Exports Continue to Perform Strongly', Article from *Asialine*, June 1999, http://www.dfat.gov.au/geo/na/japan/articles_asialine_rice.html (28 February 2000).

6.95 The population of farmers in Japan is ageing quite rapidly and the average size of a farm in Japan is very small at little more than one hectare. The new agricultural basic law will not allow large companies such as Mitsubishi and Mitsui to buy up huge tracts of Japanese land and conduct company farming. Rather, it is intended to allow groups of farmers who are currently producing agricultural commodities to turn themselves into companies. 'It is a kind of a collective agriculture, but it is private'. The rice growing industry in Japan will ultimately need to undergo radical change.¹¹⁵

6.96 Even though exporting rice to Japan can be frustrating at times due to the complicated import mechanisms which remain heavily controlled by the Ministry of Agriculture, Forestry and Fishery through its Food Agency division, the Ricegrowers Co-operative remains committed to the Japanese market. It accepts that, in Japan, rice is an extremely sensitive issue of great political importance. Furthermore, it acknowledges the efforts that the Japanese Government is making to liberalise this highly sensitive industry and it looks forward to future growth. It sees a need for government involvement in facilitating trade and a partnership between the Australian industry and the Australian Government. For example, there is still much to be done towards the liberalisation of trade in agriculture through the next round of the WTO. The Ricegrowers Co-operative told the Committee:

If we are not successful in having further agreement from Japan on liberalising its market through that round, then it will be many years down the track before we will have another opportunity.¹¹⁶

Sugar

6.97 Raw sugar is Australia's second largest crop export after wheat with annual export sales in 1997–98 of \$1.7 billion. This accounts for 85% of the industry's production. With gross value of sales exceeding \$2 billion annually, sugar is Australia's fifth largest rural industry, based on gross value of production, after wheat, beef, wool and dairy.¹¹⁷

6.98 Throughout the 1960s, sugar was one of Australia's top export commodities to Japan but in the 1970s it started to lose ground and during the 1980s its value as an export declined markedly. In contrast, products such as meat and fish were gaining a larger share of Australia's export market to Japan. Although sugar is no longer a major export to Japan, Australian sugar exporters would like to improve their access to this market and, furthermore, ensure that the demand for sugar in Japan does not

115 Aurelia George Mulgan *Committee Hansard*, 28 May 1999, p. 684; Milton Bazley, Ricegrowers Co-operative Ltd, *Committee Hansard*, 17 May 1999, p. 539; Dr Dennis Gebbie, Department of Agriculture, Fisheries and Forestry, *Committee Hansard*, 28 May 1999, p. 664.

116 Bernard Bazley, Ricegrowers Co-operative Ltd, *Committee Hansard*, 17 May 1999, p. 540.

117 Warren Males, Queensland Sugar Corporation, *Committee Hansard*, 16 April 1999, p. 454.

suffer because of regulations. In 1999, Australia's share of Japan's sugar imports was an impressive 39.6%.¹¹⁸

6.99 Difficult hurdles confront those wishing to import sugar into Japan. As with rice, the Japanese Government is seeking to shield local producers from foreign competitors. The Queensland Sugar Corporation (QSC) told the Committee that it is keen to continue its strong marketing ties with Japanese customers. It is, however, concerned about the effects of the sugar price stabilisation law on Japan's domestic sugar market—in particular, on consumption and import levels. Mr Warren Males Principal Economist, QSC, explained this legislation:

Under the law, import prices are increased to domestic price levels through the activities of the Agriculture and Livestock Industries Corporation which is known through its acronym of ALIC. Each importer is required to sell all imported sugar to the ALIC at the average import price current at the time of the import declaration. In a simultaneous transaction the ALIC sells back the same sugar to the same importer at a higher price, which includes import duties, levies and surcharges. The levies and surcharges collected are used to produce the subsidies to encourage production.¹¹⁹

6.100 According to QSC, the law is not achieving its stated objectives. Under this law, domestic prices are maintained at levels significantly higher than the world price—almost 20 times the world level. These high domestic prices are altering the structure of sweetener consumption in Japan where alternative sweeteners are being substituted for sugar.

6.101 In the face of falling world sugar prices and the lower tariff levels, Japan has increased the surcharges imposed on imported sugar leaving the high domestic prices largely unchanged. With domestic prices stabilised, sugar users in Japan have not received any price incentives to increase their sugar consumption.

6.102 The irony, as pointed out by QSC, is that even though total sweetener consumption is steady in Japan at around 3.3 million tonnes a year, these high domestic sugar prices have reduced sugar's share of the sweetener consumption in Japan and caused a switch to alternative sweeteners and to sugar blends. It argued that, while sugar prices have been stabilised, this has been at an enormous cost to the Japanese consumers and the world sugar trade. The law has succeeded in discouraging consumption and increasing competition from substitutes. Put bluntly it asserted:

The higher prices are not sufficient to increase domestic sugar production. Self sufficiency has not been achieved. Sugar imports have fallen.¹²⁰

118 Additional information supplied to the Committee by DFAT, 18 May 2000.

119 Warren Males, Queensland Sugar Corporation, *Committee Hansard*, 16 April 1999, p. 454.

120 Warren Males, Queensland Sugar Corporation, *Committee Hansard*, 16 April 1999, p. 456.

6.103 Consequently, there has been strong growth in imports of sugar-containing products and imports of maize and other starch-based products which do not attract such high duties or levies. QSC argued that the Japanese Government is reluctant to reform its sugar policy beyond the bare minimum requirements under the WTO. The Queensland raw sugar industry is seeking liberalisation of the current sugar regime in Japan. It insisted that ‘Australia must lead the charge on trade reform in sugar’.¹²¹ It suggested that an ad valorem tariff would be preferable to the complicated system of duty, surcharges and levies contained in the stabilisation law. A tariff would allow domestic prices to reflect changes in world prices albeit at a higher level.

6.104 The QSC stressed the point that Australians need to encourage an open and honest discussion of the merits of current sugar policy regimes, their effectiveness and implications for world trade. It stated further:

...we are not disputing the Japanese government’s ability to support its domestic industry. We would like to see them provide that support in a way which is transparent, in a way which enables the producers to respond to price decisions in their production decisions.¹²²

6.105 One approach suggested by Mr Philippe Ingram, Manager, Japan Secretariat, Department of State Development, Queensland, would be to open up public debate in Japan about protectionism. Drawing on his experience, he told the Committee that most Japanese are not aware of the importance of trading issues, such as the beef and rice tariff, to Australians because ‘95 per cent of them live in big cities and they do not know where their food comes from anyway’. He submitted that there ‘are ways of explaining to the public how they benefit from liberalisation, which I do not think the Japanese government has done at all’.¹²³

Wheat

6.106 Australia is a small producer of wheat but a large trader and exporter. In 1995–96, wheat accounted for 4% of total Australian exports; in 1996–97 it jumped to 5% before settling back to 4% of total exports in 1997–98 and in 1998–99 it raised revenue of \$3.4 billion.¹²⁴

6.107 Japan is a major purchaser of Australian wheat and since the 1960s, it has consistently taken about a million tonnes of wheat every year. Wheat is regarded in Japan as an important staple and is classified as an item of state trading. As such, its

121 Warren Males, Queensland Sugar Corporation, *Committee Hansard*, 16 April 1999, p. 454.

122 Warren Males, Queensland Sugar Corporation, *Committee Hansard*, 16 April 1999, p. 467.

123 Philippe Ingram, Department of State Development, Queensland, *Committee Hansard*, 16 April 1999, p. 412.

124 *Year Book* no. 79—1997, p. 707; no. 80—1998, p. 775; no. 81—1999, p. 745 and no. 82—2000, p.791. Note principal market information is confidential—see footnotes 20 and 78.

importation comes under the strict control of the Japan Food Agency (JFA). Despite the downturn in the Japanese economy, wheat exports are not expected to be greatly affected in the short term.¹²⁵

6.108 Under the Wheat Marketing Act 1989, the Australian Wheat Board Ltd (AWB) has been delegated single desk export authority which means that it is the sole exporter of wheat from Australia. The AWB enjoys a special arrangement with the Japanese Government, through the JFA, which allows Australian wheat exporters access to the Japanese market. The JFA values its dealings with Australian wheat growers because they provide security of supply and a high quality product and service. In return, Australian producers are rewarded with a 'virtually guaranteed access' to this prized market. Australia's market share in Japan has been stable at between 19% and 20% and is fortunate to be amongst three overseas countries sharing this market.¹²⁶ As explained by Mr Simon Burgess:

...there is no doubt the arrangement that is currently in place effectively apportions a share of the trade to America, Canada and Australia.¹²⁷

6.109 Hence, unlike beef, rice and sugar exporters who experience difficulties in getting their products into Japan, wheat growers are not directly concerned about impediments to trade regarding importing wheat into Japan.¹²⁸

6.110 The AWB has been aware of Japan's concern over food security.¹²⁹ It explained:

...in terms of their heavy reliance on exports, they continue to have to feed their population, so we are probably a little bit buffered from both the internal and external economic turmoil in the region. That, I suppose, has given us a much steadier keel...I would not expect a major change in the long term.¹³⁰

6.111 The AWB has also been fully cognisant of the pressure on the Japanese to deregulate their market and it acknowledged that some Australian exporters, such as rice and sugar growers, have a strong interest in further deregulation. For wheat growers, however, there is a choice between the stable market share they now enjoy or

125 Simon Burgess, Australian Wheat Board, *Committee Hansard*, 19 February 1999, pp. 76, 83; Dr Terence Sheales, ABARE, *Committee Hansard*, 21 June 1999, p. 732; Australian Wheat Board Ltd, submission no. 27, p. 6.

126 Simon Burgess and Andrew McConville, Australian Wheat Board Ltd, *Committee Hansard*, 19 February 1999, pp. 75–6, 81; Grains Council of Australia, submission no. 24, p. 1.

127 Simon Burgess, Australian Wheat Board Ltd, *Committee Hansard*, 19 February 1999, pp. 80–1.

128 Dr Terence Sheales, ABARE, *Committee Hansard*, 21 June 1999, p. 732.

129 Simon Burgess, Australian Wheat Board Ltd, *Committee Hansard*, 19 February 1999, p. 85.

130 Andrew McConville, Australian Wheat Board Ltd, *Committee Hansard*, 19 February 1999, pp. 86–87.

a possible larger share of the cake. The AWB and the Australian Grains Council believed that Australia should not push for the dismantling of the JFA because of Australia's long established and close relationship with this organisation. Overall, the AWB considered that deregulation would not benefit Australian wheat growers and that the dismantling of the JFA could result not only in stiffer competition in the Japanese market but also the possibility of losing the premiums Australian wheat growers enjoy. Mr Burgess conceded that there is a trade-off 'as to what our share is and whether we buck the system to push for deregulation'. The AWB recognised, however, that Australian wheat producers do need to be prepared for deregulation to ensure that they are well positioned to take advantage of any such reform.¹³¹

6.112 AWB's priorities in terms of the next round of the WTO are focused not on the Japanese barriers to trade but on the actions of major competitors, the US and the European Union in particular, in providing high levels of domestic support arrangements and export subsidies to their local producers.¹³² This places producers such as Australian farmers, who do not benefit from government subsidies, at a disadvantage in the international market.

6.113 In common with many other producers, Australian wheat exporters understand that the Japanese are willing to pay a premium for quality. Thus, they have decided to concentrate on producing wheat that gives them a comparative advantage over their competitors—wheat for noodle production. Although Australia supplies some of the highest quality wheat to Japan, the AWB nonetheless is looking at developing new and different wheat and at ways of improving the products that they produce with Australian wheat. It works with the JFA to develop specific products.¹³³

Wool

6.114 The Australian wool industry dominates the world market for wool. Australia produces one-third of the world's total wool production, half the world's wool that goes into clothing and 70% of the world's merino wool. Wool is a significant export earner for Australia.¹³⁴

6.115 The industry is exposed to global economic circumstances. The 1990s was a difficult decade for wool with a collapse in demand in key consuming countries in Eastern Europe and economic stagnation in Western Europe and Japan. More recently, the Asian crisis and the downturn in China has further eroded demand for wool.

131 Simon Burgess, Australian Wheat Board Ltd, *Committee Hansard*, 19 February 1999, pp. 77–8, 80–81.

132 Andrew McConville, Australian Wheat Board Ltd, *Committee Hansard*, 19 February 1999, p. 82 and the Grains Council of Australia, submission no. 24, p. 2.

133 Andrew McConville, Australian Wheat Board Ltd, *Committee Hansard*, 19 February 1999, pp. 83–4.

134 Christopher Wilcox, The Woolmark Company, *Committee Hansard*, 17 May 1999, p. 507.

6.116 Australian wool exports to Japan have fallen markedly in value over the last decade. Japan is a vital market for Australia's wool and the decline in its economy in the 1990s seriously affected Australia's wool industry and contributed substantially to its problems.¹³⁵ Ten years ago, Japan was the number one export destination for Australian wool. In 1989, Australia exported wool valued at \$1.004 billion to Japan. This represented 8% of Australia's total exports to Japan and 20% of Australia's world-wide wool export market. By 1998, the value of Australian wool exported to Japan stood at just \$193 million, a fall of 81% over the ten year period. This accounted for only 1% of Australia's total exports to Japan and 7% of world wide wool exports. In 1998, China was the primary destination for Australian wool, accounting for over 20% of exported wool. Italy was Australia's second most important wool buyer taking over 18% of Australian wool.¹³⁶ In 1999, the value of wool exports to Japan fell further to \$154 million. Despite the sharp decline in the value of wool exported to Japan, Australia is still Japan's principal supplier of wool accounting for 34.8% of Japan's total wool imports for 1999.¹³⁷

6.117 The fall in the value of wool exports to Japan is due to a combination of factors—a decline in final consumption of wool because of Japan's economic problems; high stocks of semi-processed wool, loss of competitiveness in Japan's wool processing industry and a shift in location of processing away from Japan to other more cost-effective countries; including China, Korea, Taiwan, Thailand, Malaysia and Australia.¹³⁸

6.118 Japan's wool processing industry is finding it difficult to compete with these countries, particularly given that its labour costs are amongst the highest in the world in the textile industry—five or six times as much as in other countries such as China,

135 Christopher Wilcox, The Woolmark Company, *Committee Hansard*, 17 May 1999, p. 508.

136 Market Information and Analysis Unit, Department of Foreign Affairs & Trade, *Composition of Trade Australia, 1998*, Canberra, p. 30. The value of Australian wool exported in 1998 was \$2.872 billion with China taking \$591 million and Italy \$539 million.

137 Australian Bureau of Statistics, 'Australia Now—A Statistical Profile', International Accounts and Trade, Feature Article—Australia's merchandise trade with Japan, <http://www.statistics.gov.au/with.../bde7ace2081c70e6ca25677b00077c49?OpenDocument> (30 November 1999) (page 10 of 15). The ABS gave the unusually high figure of 79% for Australia's share of Japan's wool imports in volume terms for 1997–98. According to Woolmark, a decade ago wool had about a 17% share of Australia's exports. By 1997–98 it had fallen to fifth place with a 6% share. Australian exports to Japan totalled about \$259 million in 1997–98 compared with 1.29 billion 10 years ago. Christopher Wilcox, The Woolmark Company, *Committee Hansard*, 17 May 1999, p. 508. DFAT stated that Australia's wool share fell in 1998, but it was still almost 48% of the Japanese market. See Karen Gilmour, DFAT *Committee Hansard*, 15 February 1999, p. 21.

138 Australian Bureau of Statistics, 'Australia Now—A Statistical Profile', International Accounts and Trade, Feature Article—Australia's merchandise trade with Japan, <http://www.statistics.gov.au/with.../bde7ace2081c70e6ca25677b00077c49?OpenDocument> (30 November 1999) (page 10 of 15) and Mr Christopher Wilcox, The Woolmark Company, *Committee Hansard*, 17 May 1999, p. 508.

Thailand and Malaysia.¹³⁹ Fully aware of their uncompetitive production costs, especially in the early stage processing, Japanese wool processors have invested substantially in these more cost-effective countries.

6.119 Thus, Japan is increasingly importing products in either final form or as fabric and yarn. Imports of products, such as yarn, fabrics and garments, have increased from 41% in the early 1990s to 64% in 1998.¹⁴⁰ Despite this trend, according to the Woolmark Company, Japan will remain a significant manufacturer of high-quality yarns and fabrics and will import the 'run-of-the-mill' yarns, fabrics and clothing.

6.120 The substitution of cotton and synthetic fibres is another factor undercutting demand for wool and forcing down world export prices. In essence, the key to wool sales is final demand—the garments that end up in wardrobes—and Japan's final wool consumption has declined by 25% through the 1990s. This huge drop in such an important market is due mainly to the very difficult economic situation in Japan.¹⁴¹

6.121 During a period of economic downturn, price competitiveness also comes into play and consumers will become even more price conscious where value for money becomes a major consideration. The wool textile pipeline tends to be more costly than the equivalent for cotton and synthetics, with wool garments asking about twice the price of the equivalent in other fibres. Thus wool garments are particularly income sensitive which means that the poorer the income growth rates the lower the wool consumption as consumers turn to more price competitive products, including synthetic fibres. This pattern is particularly evident in Japan, where synthetic fibres have usurped a significant share of the Japanese final market from both wool and cotton. Producers of synthetic fabrics have won over consumers with their innovation in devising new attractive products that have flair and style.¹⁴²

6.122 Changing fashions and tastes, such as the trend away from formal wear to more casual styles, are affecting the demand for wool garments. Demographic trends are important also, particularly in Japan with its ageing population as well as the move away from buying clothing in favour of electronics, travel and so on.

6.123 The challenge for wool is to adapt to the changes occurring in the Japanese lifestyle and in the fashion market—to create interest in, and demand for, wool garments. The Woolmark Company is prepared to meet this challenge and is looking to develop and promote innovative wool products in Japan to appeal to the smart casual and active leisure wear market and generally to respond to consumer trends, for

139 Dr Terence Sheales, ABARE, *Committee Hansard*, 21 June 1999, p. 732.

140 Christopher Wilcox, The Woolmark Company, *Committee Hansard*, 17 May 1999, p. 508.

141 Christopher Wilcox, The Woolmark Company, *Committee Hansard*, 17 May 1999, p. 508.

142 Christopher Wilcox, The Woolmark Company, *Committee Hansard*, 17 May 1999, pp. 508–9.

example, in wool blends that retain the reputation for quality but are less expensive.¹⁴³ The Woolmark Company submitted that, because of Japan's lead role throughout Asia in wool processing, it has established a development centre in Ichinomiya to speed up the adoption of new products in Japan and throughout the rest of Asia.¹⁴⁴

6.124 Japan is a well-established trading partner particularly through the large trading houses. The closure of one of the large Japanese trading houses, Nissho Iwai, in May 1999 reflected the much lower volumes of trade, particularly in raw wool production.¹⁴⁵ There is an over capacity in many sectors of the wool textile pipeline, particularly in early stage processing where there is about a 25% or 30% over capacity worldwide. This situation is encouraging a fundamental restructuring of the industry.¹⁴⁶ Even so, a revival in economic growth would boost demand for wool.

6.125 There has been a shift in Australia in the early stage processing—scouring and production of tops. About a third of Australia's raw wool is now turned into some value added product in Australia and then exported. According to the Woolmark Company, there is some interest in yarn production but the key challenge for the Australian textile industry is the high labour costs and the fact that we already have established customers around the world, such as Italy, who want to buy a raw product.¹⁴⁷

Trade liberalisation and agriculture in Japan

6.126 Clearly, a boost in Japan's economy will give encouragement to many Australian exporters. But for the agricultural sector, as noted by the beef, rice and sugar industries, trade liberalisation is most important. The powerful agricultural lobby groups in Japan make it particularly difficult to move this process of deregulation ahead. The development in Japan of approaches to so-called non-trade issues, including social and environmental matters, which are most commonly placed under the heading 'Multifunctionality of agriculture' is an area of great significance for future multilateral negotiations. It is an area fraught with risk for Australia's efforts to achieve greater liberalisation of agricultural trade in the WTO.¹⁴⁸

6.127 The Japanese Government believes that appropriate levels of agricultural production should be maintained in Japan to enhance the environmental benefits of agriculture including the prevention of soil erosion, landslides and floods and for the

143 Christopher Wilcox, The Woolmark Company, *Committee Hansard*, 17 May 1999, p. 509.

144 Christopher Wilcox, The Woolmark Company, *Committee Hansard*, 17 May 1999, p. 512.

145 Cathy Bolt, 'Japan wool buyer bales out from Australia', *Financial Review*, 4 May 1999.

146 Christopher Wilcox, The Woolmark Company, *Committee Hansard*, 17 May 1999, p. 511.

147 Christopher Wilcox, The Woolmark Company, *Committee Hansard*, 17 May 1999, p. 517.

148 Dr Dennis Gebbie, Department of Agriculture, Fisheries and Forestry, *Committee Hansard*, 28 May 1999, pp. 659–60.

conservation of its water resources. In defending its stand on the 'multifunctionality of agriculture', the Japanese Government argues strongly that agriculture in Japan warrants government support, including border measures, to ensure that its functions go beyond merely producing food to embrace other aspects that benefit society such as maintenance of the ecosystem, conservation and rural development.¹⁴⁹

6.128 At a time when Australia is looking to expand its agricultural market through trade liberalisation, Japan is sending mixed messages. In May 1999 the Japanese Ministry of Agriculture, Forestry and Fisheries (MAFF) explained that it wanted to see 'truly fair' trade rules established. It wanted, however, the principle of 'multifunctionality of agriculture' to inform any such rules set down in the WTO negotiation on agriculture.¹⁵⁰

6.129 While food security, environmental protection and the wellbeing of agrarian communities are legitimate concerns for the Japanese people, such arguments could also be used to justify the sorts of very high levels of protection that still exist in Japan. The OECD has developed a producer subsidy equivalent (PSE) which measures the percentage of a farmer's income made up of government assistance. Japan's average PSE is high at 69% compared to Australia's which is 9%. The OECD average is 34%. Even for a highly protected region like the European Union, the figure for average PSE is 42%.¹⁵¹

6.130 The Japanese agricultural lobby seeks aggressively to maintain a highly protected Japanese agricultural sector. While the influence of that lobby group may have waned, there is the prospect that the WTO agricultural negotiations will spur it to renewed efforts to shield Japan's agricultural sector from outside competition.

6.131 Japan's overall lack of a firm commitment to trade liberalisation in agriculture has become increasingly apparent since the APEC leaders meeting in Kuala Lumpur in 1998 when Japan managed to give only equivocal support for the early sectoral liberalisation initiative and agreed to refer the matter to the WTO. Indeed, toward the end of 1999 as the WTO negotiations approached, food security loomed large as a major preoccupation for Japan and was raised during the WTO ministerial conference in Seattle. During this session, Japan told Ministers at the meeting that the WTO must address issues arising from the impact of trade liberalisation on matters such as 'environmental protection, food safety, the maintenance of agrarian communities, and the preservation of culture and tradition'. It stressed the importance of giving due consideration to redressing 'the imbalance of rights and obligations between food

149 For a definition of 'multifunctionality of agriculture' see, MAFF Update, No. 309, 14 May 1999, <http://www.maff.go.jp/mud/309.html> (17 March 2000).

150 MAFF Update, No. 309, 14 May 1999, <http://www.maff.go.jp/mud/309.html> (17 March 2000).

151 Dr Dennis Gebbie, Department of Agriculture, Fisheries and Forestry, *Committee Hansard*, 28 May 1999, p. 661.

importing and exporting countries' as well as the multifunctionality of agriculture.¹⁵² The disappointing outcome of the WTO talks in Seattle at the end of 1999, when talks were suspended, makes the concerted effort by both Japan and its trading partners to resume the WTO agriculture negotiations all the more important for Australia.

6.132 Given that Japan is Australia's most important export market for agricultural products, it is important that Japan remains committed to agricultural trade liberalisation, the dismantling of non-tariff barriers and rejection of protectionist policies. Japan's recent decision to set the rice tariff at 390% for rice imports is not a promising sign for future trade liberalisation nor is the emphasis it chose to give to food security and the multifunctionality of agriculture during the WTO talks in Seattle.

6.133 The Committee believes that to safeguard and promote its trading future, Australia must continue to argue in international fora for the liberalisation of trade, particularly in agriculture. It found the decision by APEC to refer the early sectoral liberalisation initiative to the WTO as a second best option and, in light of the lack of progress at the Seattle meeting of the WTO, believes that APEC should once again pursue this matter with determination.

Recommendation

The Committee recommends that the Australian Government, with renewed effort, seek the cooperation of countries such as Japan to reinvigorate the APEC process in setting down achievable goals toward the realisation of trade and investment liberalisation.

6.134 The Committee acknowledges the need to continue to encourage Japan to liberalise its highly protected agricultural markets, which includes going beyond its Uruguay Round commitments on trade liberalisation and to implement greater reforms on market access and domestic support. It found the failure of the third WTO ministerial conference to launch a new round of multilateral trade negotiations regrettable and the lack of leadership shown by the world's leading economies disappointing.

152 Statement by H.E. Mr Yohei Kono, Minister for Foreign Affairs, Ministerial Conference, 1 December 1999, WTO WT/MIN(99)/ST/26.

Recommendation

The Committee recommends that the Australian Government urge like-minded countries seeking greater liberalisation in agricultural trade to lobby for the commencement of the new round of WTO trade talks at the earliest possible date.

Export of services to Japan

Overview of Australia's trade in services

6.135 Service exports grew steadily throughout the 1990s and, although Australia remained a net importer of services, the size of the net import ratio has declined. This shift from being a 'persistent net importer to a net exporter' is due in large measure to Australia's growing tourism industry and to a lesser extent the export of education services. In 1996, one economist predicted that the demand for both these services 'could exhibit bandwagon effects as more satisfied tourists and students report home and as Australian suppliers become more attuned to Asian customers.'¹⁵³

Export of services to Japan

6.136 Since 1987–88 and up till very recently, Japan has been the principal destination for Australian services exports. The growth rate in the export of services to Japan has slowed since 1991–92, due in the main to the downturn in the Japanese economy.¹⁵⁴

6.137 In 1995–96, the value of exports of services to Japan reached \$3.9 billion accounting for 17% of total Australian services exports. Although the value of Australia's exports in services to Japan fell to \$3.7 billion in 1996–97, it nonetheless represented 15% of Australia's total export of services and was higher than the value of service exports to the United States, which stood at \$3.2 billion or 13% of Australia's total services exports. In 1997–98, however, the United States pipped Japan as Australia's main destination for services exports with the value of Australia's exports of services to Japan at under \$3.6 billion while the United States had jumped ahead with a value of \$3.9 billion.¹⁵⁵ This gap further widened in 1999 with the value of exports of services to Japan falling to \$3.4 billion or 12.3% of total services exports

153 Richard Pomfret, 'Australian Experience with Exporting to Asia', *Seminar paper 96-01*, Centre for International Economic Studies, University of Adelaide, January 1996, pp. 11–13.

154 Department of Foreign Affairs and Trade, *Trade in Services, 1995–96*, p. 5.

155 Market Information and Analysis Unit, Department of Foreign Affairs and Trade, *Trade in Services 1996–1997*, p. 6; *Trade in Services, 1997–98*, pp. 9, 13.

and the value of exports of services to the United States rising to \$4.6 billion or 17% of Australia's total exports of services.¹⁵⁶

Tourism

6.138 In-bound tourism, has been a core component of Australia's export services for many years and has increased strongly since the mid 1980s.

6.139 The rise of Japan as an important tourist source market for Australia started in the mid-1980s. In 1986, 145,000 Japanese visited Australia and this rose to 215,000 in 1987.¹⁵⁷ Indeed, Japan has been Australia's single largest source of inbound visitors since 1990 when it eclipsed visitors from New Zealand. The number of Japanese overseas travellers peaked at 24% of Australia's total overseas visitors in 1992. In 1994, 720,937 Japanese visited Australia, in 1995 the numbers increased by 8.6% to 782,671 and rose a further 3.9% to 813,113 in 1996. In 1997, however, the growth rate slowed to only 0.1% with 813,892 Japanese visitors which then fell to 751,000 in 1998, a decrease of 7.7% on the previous year.¹⁵⁸ Nonetheless, this number accounted for 18% of all Australian inbound visitors, the largest group of tourists to Australia for that year.¹⁵⁹ In 1999, the number of Japanese visitors fell 6% on 1998 figures to represent 16% of all arrivals which allowed New Zealand to overtake Japan as the major source of overseas visitors to Australia.¹⁶⁰

6.140 Despite the significant drop in the number of Japanese visitors to Australia, overall tourist figures are holding up quite well. In 1999, 4,453,200 visitors arrived from overseas—a 7% increase on visitors from 1998.¹⁶¹ Numbers are being made up by European and American tourists.¹⁶²

6.141 According to the Australian Tourist Commission (ATC), Japan's total outbound tourism market is not expected to grow in the short term as Japan struggles with its current economic difficulties and its fragile consumer confidence. The most

156 Additional information supplied to the Committee by DFAT, 18 May 2000.

157 Australian Tourist Commission, submission no. 48, p. 1.

158 *Year Book 2000*, no. 82, p. 589; Australian Tourist Commission, submission no. 48, p. 1; Margaret Hudson, Australian Tourist Commission, *Committee Hansard*, 14 April 1999, p. 251; Junzo Yamaguchi, Japan Travel Bureau Australian Pty Ltd, *Committee Hansard*, 3 September 1999, p. 813.

159 Junzo Yamaguchi, Japan Travel Bureau, Australia Pty Ltd, *Committee Hansard*, 3 September 1999, p. 813.

160 Australian Bureau of Statistics, No. 3401.0—Overseas Arrivals and Departures, Australia, December 1999; Australian Tourist Commission, Short Term Overseas Visitor Arrivals, Year Ending December 1999, <http://www.atc.net.au/intell/data/99end.htm> (18 April 2000). In 1999, there were 707,463 short-term visitors from Japan and 728,798 from New Zealand.

161 Australian Bureau of Statistics, No. 3401.0—Overseas Arrivals and Departures, Australia, December 1999.

162 Karen Gilmour, DFAT, *Committee Hansard*, 15 February 1999, p. 34.

significant factor in the reduced levels of Japanese visitor arrivals is that almost 85% of Japanese short-term overseas travellers are holiday-makers and the Japanese share of this market is a substantial 29%. Most importantly, Japanese tourists spend more per day in Australia than any other overseas visitors. According to the BTR, Japanese visitors spend \$114 per day, while the average spent by other foreign tourists is \$80.¹⁶³

6.142 Thus the decrease in the number of Japanese tourists has serious implications for the Australian economy as this market has been a significant export earner for Australia, believed to be around \$3 billion per annum at the moment. This makes it one of Australia's key export items.¹⁶⁴

6.143 The decline in the number of Japanese travelling to Australia is reflected in the market for air travel, which has weakened in spite of the efforts to turn it around. Overall there has been a significant fall in total airline seats from Japan into Australia. Continued lack of profitability caused Qantas reluctantly to reduce services in November 1998 beyond the anticipated levels. The number of seats available dropped by 30% between 1998 and 1999. Overall the market in early 1999 was still falling and the Japan-Australia route continued to make a loss.¹⁶⁵

6.144 Not only are fewer Japanese visiting Australia but Australia's share of Japan's overseas tourist market has also dropped though only slightly. The ATC told the Committee that Australia's market share in 1997 was 4.84% and in 1998 it was 4.78% of all outbound travellers from Japan.

6.145 The economic downturn in Japan is of major and continuing concern to Australia's tourism industry. While the Japanese economy remains subdued and consumer confidence weak, potential Japanese travellers will defer their visits or look for cheaper short-haul destinations.¹⁶⁶ This trend is part of an overall pattern of spending in Japan where consumers are more careful with their money.¹⁶⁷

6.146 Australia has distinct advantages in attracting Japanese travellers to its shores. Its safe image and sites of educational value such as World Heritage listed areas and nature parks and a few major landmarks are the biggest attractions for Japanese tourists.¹⁶⁸ Australia continues to be the most preferred holiday destination for the

163 Junzo Yamaguchi, Japan Travel Bureau Australia Pty Ltd, *Committee Hansard*, 3 September 1999, p. 813.

164 Jeffrey Riethmuller, Department of Industry, Science and Resources, *Committee Hansard*, 28 May 1999, p. 703.

165 Damien Wallace, Qantas Airways, *Committee Hansard*, 14 April 1999, pp. 233–6.

166 Australian Tourist Commission, submission no. 48, pp. 4–5.

167 Janet Tomi, DFAT, *Committee Hansard*, 15 February 1999, p. 8; Margaret Hudson, Australian Tourist Commission, *Committee Hansard*, 14 April 1999, p. 258.

168 Junzo Yamaguchi, Japan Travel Bureau Australia Pty Ltd, *Committee Hansard*, 3 September 1999, p. 815.

Japanese with research showing that potential Japanese travellers consistently rank Australia, given practical considerations of time and money, as the most favoured country for a holiday or for sight seeing. The ATC explained that Australia ranked 33% on this list of most preferred holiday destinations, a position held since 1990. The United States held second place at 28%, with Italy third at 20% and Hawaii fourth at 17%.¹⁶⁹ In summary, according to the Japan Foundation:

Australia is, for the Japanese, one of the countries they feel closest to. It is the country they most want to visit and trust the most. All of our surveys tell us that.¹⁷⁰

6.147 Unfortunately, Australia's high rating on paper does not translate into actual visitors. The challenge confronting the Australian tourist industry, especially in the face of Japan's economic worries, is to entice potential Japanese travellers to Australia.

6.148 One of the main tasks for the Australian tourist industry is to broaden and refresh Australia's image. Although Australia is perceived as a safe and relaxing place offering a wealth of outdoor activities; a country of sunshine, wide beaches and unspoilt natural wonders, the number of destinations attracting Japanese tourists is low. They come here to visit a limited number of attractions—the Opera House, the Sydney Harbour Bridge, Ayers Rock and the Great Barrier Reef. This lack of dispersion around Australia is a key characteristic of the Japanese tourist market over recent years.¹⁷¹

6.149 This narrow appreciation of Australia's attractions may account for the low level of repeat Japanese visitations. About 23% or 24% or a quarter of visitors from Japan to Australia have been here before. Although the reasons underpinning this low return rate are not fully clear, most Australians involved in the industry recognise it as a problem and believe it deserves closer attention.¹⁷² The ATC has recognised this as an important issue and believes:

...it is extremely important to give Japanese visitors a number of distinct reasons to want to return to Australia...One part of that is making sure that they are aware of a range of opportunities and a range of destinations within this country.

...

169 Margaret Hudson, Australian Tourist Commission, *Committee Hansard*, 14 April 1999, p. 250 and Australian Tourist Commission, submission no. 48, p. 4.

170 Terence White, Australia-Japan Foundation, *Committee Hansard*, 19 February 1999, p. 51.

171 Australian Tourist Commission, submission no. 48, pp. 3–4.

172 Alan Loke, Qantas Airways, *Committee Hansard*, 14 April 1999, p. 247 and Margaret Hudson, Australian Tourist Commission, *Committee Hansard*, 14 April 1999, p. 254.

We therefore very strongly developed the view that we needed to introduce new destinations to the Japanese market. So what we have in place at the moment is a strategy called ‘mono destination marketing’ where we are trying to introduce new destinations to the market.¹⁷³

6.150 Clearly, Australia’s image in Japan needs to be broadened.¹⁷⁴ The Japan Travel Bureau (JTB) also stressed the need to introduce new destinations situated away from Australia’s eastern seaboard to Japanese travellers but accepted that one of the main problems is the cost of travel. Attractive destinations such as Tasmania have great potential to become popular with the Japanese market but the lack of direct flights from Japan makes airfares to these destinations very expensive.¹⁷⁵

6.151 The strongest disincentives for Japanese visitors include the time taken to reach Australia; the perceived number of tourists already here; and, importantly, the cost of the holiday.¹⁷⁶ According to the Japan Travel Bureau, the average person takes seven days holiday to come to Australia—the maximum they can visit is two cities.¹⁷⁷

6.152 The Australian Government has been working to develop the potential of the Japanese tourist market through a number of initiatives and in the 1998–99 budget provided an additional \$50 million over four years to the ATC to market and promote Australia as an overseas holiday destination. The government has also continued to develop Japan-Australia tourism relations through regular bilateral meetings at official level.¹⁷⁸

6.153 The ATC informed the Committee that it had launched the new ‘Australia Time’ promotional advertising campaign in October 1997. In its own words this campaign used ‘a combination of humour and stunning footage to promote the revitalising effects of a holiday in Australia. The campaign spearheaded a range of integrated initiatives in brand advertising, publicity and other marketing activities.’

6.154 This campaign is continually being updated and modified. Most recently, it has been complemented by an additional focus on Western Australia with the active support and input of the Western Australian Tourist Commission.¹⁷⁹

173 Margaret Hudson, Australian Tourist Commission, *Committee Hansard*, 14 April 1999, p. 254.

174 See comments by Yoshihiro Tabe, Japan Local Government Centre, *Committee Hansard*, 14 April 1999, p. 285.

175 Junzo Yamaguchi, Japan Travel Bureau Australia Pty Ltd, *Committee Hansard*, 3 September 1999, pp. 814–15.

176 Australian Tourist Commission, submission no. 48, p. 4.

177 Junzo Yamaguchi, Japan Travel Bureau Australia Pty Ltd, *Committee Hansard*, 3 September 1999, p. 815.

178 Barry Jones, Department of Industry, Science and Resources, *Committee Hansard*, 28 May 1999, p. 690.

179 Australian Tourist Commission, submission no. 48, pp. 2–3.

6.155 The ATC was also aware of the changing demographics in Japan and the importance to better target promotional campaigns to selected groups such as office ladies and the mature age or ‘silvers’ group which, because of the Japanese ageing population, is likely to assume increasing market importance.¹⁸⁰

6.156 Japanese student tourists are another group that offer substantial potential for Australia’s tourist industry. These young people, who visit Australia with school tours, are potential repeat visitors. As noted by the JTB, ‘The first experience of overseas travel is usually very impressive and encourages young people to revisit the country’. The ATC agrees with the JTB about the value of capturing the attention of young people ‘so they can experience at first hand some of the benefits of travel to Australia and then perhaps come down for their wedding and honeymoon and again as they move through to the “silvers”’. The ATC is keen to co-ordinate work being done in this area.¹⁸¹

6.157 While appreciating the ATC’s marketing programs, a number of witnesses felt that Australia needs to promote itself more effectively to the Japanese market—that their advertising products—especially their TV commercials—need to carry a more compelling message.¹⁸² The Japan Local Government Centre was more specific in submitting that Australia was not tapping the pool of potential Japanese travellers and needed to offer more familiarisation tours to the sales people over there.¹⁸³ Qantas is exploring the potential in this approach.¹⁸⁴

6.158 Australia cannot rely solely on its natural attributes to lure Japanese tourists; it must work hard to attract them. It is important to ensure that infrastructure and service delivery standards are high and meet the particular needs of visitor groups. Indeed establishing a reputation as a country that delivers a high quality tourist service might go some way to addressing the problem of the low return rate. A number of witnesses drew the Committee’s attention to specific issues that warrant serious consideration such as visa free travel; more efficient and quicker customs clearance; access by big

180 Margaret Hudson, Australian Tourist Commission, *Committee Hansard*, 14 April 1999, p. 257.

181 Junzo Yamaguchi, Japan Travel Bureau Australia Pty Ltd, *Committee Hansard*, 3 September 1999, p. 815 and see comments by Jeffrey Riethmuller, Department of Industry, Science and Resources, *Committee Hansard*, 28 May 1999, p. 703.

182 Junzo Yamaguchi, Japan Travel Bureau Australia, Pty Ltd, *Committee Hansard*, 3 September 1999, p. 816.

183 Yoshihiro Tabe, Japan Local Government Centre, *Committee Hansard*, 14 April 1999, p. 286.

184 Damien Wallace, Qantas Airways, *Committee Hansard*, 14 April 1999, p. 233. Qantas told the Committee: ‘In 1998, it, in conjunction with Australian tourism interests, provided educational trips to Australia for over 1,000 Japanese travel agency staff and media representatives. Qantas will provide approximately 1,500 further educational visits for agents and media during calendar 1999. We believe that the provision of a hands-on look at the Australian product is a very valuable tool to put in the hands of those in a position to sway the consumer’s choice of destination.’

coaches to Sydney airport and parking facilities in the city.¹⁸⁵ Japanese returning from Australia could be the tourist industry's best advertisement.

6.159 The ATC wanted to restate its belief in the long-term importance of the Japanese market as a very strong and very significant source of visitor arrivals into Australia. It believed that the underlying popularity of Australia as a destination will continue, and is therefore very confident that in the longer term Japan will return to growth and continue its importance as a key source of arrivals into Australia.¹⁸⁶ Over the next 10 years, growth in visitor arrivals from Japan is expected to increase by an average of around 6% a year.¹⁸⁷

6.160 The Committee accepts that although there has been a fall in Japanese visitors coming to Australia, due in large measure to the economic downturn in Japan, the potential for growth in this market exists. It believes the time is ripe for the Australian tourist industry to look carefully at its overseas image and to use this downturn as an opportunity to refresh and rejuvenate Australia's overseas profile. It is also an opportunity to reassess and upgrade the infrastructure and the standard of delivery of tourist services.

6.161 The Committee believes that the recent slump in the number of Japanese visitors to Australia provides an ideal opportunity for the Australian tourist industry to reflect on their performance and on how they can improve it. They should seek to assess the quality of service delivery in the industry, the standard of facilities for overseas tourists, whether they meet visitor expectations and identify areas where Australia can deliver a better service. Areas mentioned by witnesses, such as visa requirements, customs clearance, coach access and parking facilities should only be the starting point of a more thorough and comprehensive assessment which should also look at travel costs and schedules and facilities, including hotels, guide services, shopping and reception.

Recommendation

The Committee recommends that the Australian Government commission a comprehensive study into the Australian tourist industry, using Japanese tourists as a case study and keeping in mind their low level of repeat visits, to ascertain how it can improve the standard of delivery of tourist services and broaden its overseas image.

185 Junzo Yamaguchi, Japan Travel Bureau Australia Pty Ltd, *Committee Hansard*, 3 September 1999, pp. 814–15;

186 Margaret Hudson, Australian Tourist Commission, *Committee Hansard*, 14 April 1999, p. 251.

187 Barry Jones, Department of Industry, Science and Resources, *Committee Hansard*, 28 May 1999, p. 690.

Education

6.162 Education is an important export industry to Asia. Japan continues to be one of Australia's more important education export markets and was the sixth largest in 1998. The number of student visas issued to Japanese students onshore and offshore declined by 10% in 1998 to 9,400 due largely to the effect of the Asian financial and economic downturn.

6.163 According to the Department of Education, Training and Youth Affairs, there were about 10,800 Japanese students studying in Australia in 1998. This figure represents a decline of 9% from 1997. In addition, about 18,000 Japanese tourists enrolled in some form of study while visiting Australia in 1998. Japanese students studying in Australia on student visas generated an estimated revenue of about \$200 million in 1998. The Department told the Committee that preliminary estimates indicate that there will be some continuing decline in Japanese student enrolments but at a slower rate. It expected them to pick up in the medium to longer term.¹⁸⁸

6.164 The Department of Education is confident that Australia's image as a safe study destination, together with a growing awareness of the high quality of education available here, will help Australia win an increasing share of the Japanese education market in the medium to longer term.¹⁸⁹

6.165 Some witnesses, however, thought that Australian educational institutions had a challenging job ahead of them in drawing students to Australia's shores. According to Professor Yoshio Sugimoto, Australia is losing bright Japanese students to universities in the United States and Europe. He noted that many Australian universities have established institutional links in the exchange programs with Japan's universities and colleges, but they are mainly with second-class and third-rate institutions. Put bluntly, Australian universities have failed to attract top students from Japan—a situation that requires serious long-term planning.¹⁹⁰

6.166 Mr David Askew, a lecturer in Japanese studies, did agree with Professor Sugimoto that Australia was attracting students from second and third rate Japanese universities. He pointed out, however, that even if Japanese students coming to Australia were from lower rating universities they nonetheless would be 'wonderful sources of students for Australia'.¹⁹¹ The Committee agrees with this view but nonetheless is concerned about the overall low profile of Australian universities in Japan.

188 Robert Horne, Department of Education, Training and Youth Affairs, *Committee Hansard*, 28 May 1999, p. 707.

189 Robert Horne, Department of Education, Training and Youth Affairs, *Committee Hansard*, 28 May 1999, p. 707.

190 Professor Yoshio Sugimoto, *Committee Hansard*, 17 May 1999, pp. 520–1.

191 David Askew, *Committee Hansard*, 17 May 1999, p. 555.

6.167 In ranking universities, the Japanese student community does not place Australia at the top. The United States, with its commanding presence in mass media and in popular culture, and Europe, with its strong reputation and acknowledged tradition, are preferred to Australia. A young country, Australia has yet to establish a name in the international academic community. According to Professor Yoshio Sugimoto, Australian tertiary institutions have not campaigned sufficiently strongly in Japan where a lot of recruitment programs are in operation from various countries. Professor William Coaldrake, supported by a number of witnesses, stated that Australia needs to explore ways of attracting Japanese students to Australia.¹⁹²

6.168 Demographic changes in Japan will influence the demand for educational services. A falling birth rate in Japan means that there will be fewer young Japanese people seeking places in Australian educational institutions. However, even though families may be smaller, this does not mean that the family's investment in their children is insignificant. The education of children is still considered a priority in Japan and travel is an important aspect of education. Australia's proximity to Japan and favourable exchange rate mean that Australia will be a viable choice.¹⁹³

6.169 Given the recession, however, and the fall in consumer confidence, Japanese students are far more careful in spending on education. Expenditure on private education in Japan went down in a year by 18%. Overseas education is expensive and Japanese students may well choose less expensive options. Moreover, the sector of the market in which Australia is active—short courses for learning English—is vulnerable when consumer confidence is weak and people are looking to save not spend. The Department of Education suspects that the drop in overseas student numbers has been more pronounced for Australia than for the United States.¹⁹⁴

6.170 The low rate of economic growth in Japan and Australia's low profile in the academic world means that Australia will have to work hard to present itself as a worthy competitor to American and European institutions. Ms Rebecca Cross, Assistant Secretary, Australian Education International (AEI), stated:

What we are primarily trying to do is to raise the awareness of Australia as a study destination in the mind of potential students, because the first decision that a student makes when they are studying overseas is to choose the country. So to some extent we do need to raise awareness and we do market

192 Professor Yoshio Sugimoto, *Committee Hansard*, 17 May 1999, p. 525; Professor William Coaldrake, *Committee Hansard*, 17 May 1999, pp. 579–81; See also comments by Professor Alan Rix, *Committee Hansard*, 16 April 1999, pp. 452–3.

193 Dr Carolyn Stevens, *Committee Hansard*, 17 May 1999, p. 572.

194 Robert Horne, Department of Education, Training and Youth Affairs, *Committee Hansard*, 28 May 1999, pp. 707–8.

Australia as a high quality, safe environment and a good study destination.¹⁹⁵

6.171 AEI's marketing campaign—the Study in Australia 2000 campaign—carried this message about the quality of Australia's education system.¹⁹⁶ The biggest demand from Japan for education in Australia is to learn English, the so-called ELICOS (English Language Intensive Courses for Overseas Students), which accounts for two in every five Japanese students. The Committee found, however, that in this area, where Australia does have a presence and a great opportunity to showcase the high quality of Australian education and standards of service delivery, it is failing to promote itself as a provider of high quality education, indeed, it is creating a negative impression.

6.172 Professor Sugimoto told the Committee that he had heard Japanese language students studying in private language schools in Australia express dissatisfaction.¹⁹⁷ The Department of Education conceded that they receive 'criticisms occasionally from students who are disenchanted with the courses that they are being offered'. It went on to state:

Sometimes they will criticise the institution for low quality; and occasionally we have had criticisms or allegations the courses are not in fact even provided, that they are shopfront institutions.¹⁹⁸

6.173 The Committee realises that Australia has a challenge ahead in competing with established and world recognised educational institutions in attracting Japanese students. Nonetheless it has an opportunity to promote the reputation of Australia's education system and to encourage Japanese students to undertake further study in Australia through the ELICOS courses. Evidence suggests, however, that some of these courses are falling short in presenting a positive image of education in Australia. Clearly, this is an area that requires attention and calls for closer co-ordination between the state departments of education and the Federal Government.

195 Rebecca Cross, Department of Education, Training and Youth Affairs, *Committee Hansard*, 28 May 1999, p. 711.

196 Rebecca Cross, Department of Education, Training and Youth Affairs, *Committee Hansard*, 28 May 1999, p. 711.

197 Professor Yoshio Sugimoto, *Committee Hansard*, 17 May 1999, p. 525. He told the Committee that 'anecdotal evidence suggests that some private language institutions are not providing good quality education because of the relatively poor quality of teachers'.

198 Sara Cowan, Department of Education, Training and Youth Affairs, *Committee Hansard*, 28 May 1999, p. 709.

Recommendation

The Committee recommends that the Australian Government confer with State Governments to ensure that educational institutions offering ELICOS (English Language Intensive Courses for Overseas Students) maintain high standards in education and the service they deliver to overseas students.

CHAPTER 7

RECESSION, REFORM AND OPPORTUNITIES

Japan is a nation of sleeping consumers.¹

Introduction

7.1 In the previous chapter, the Committee focused on assessing the effects of the Japanese recession on the Australian economy through trading and commercial links. The Committee also considered some of the barriers to trade with Japan, including tariffs and quotas. In this chapter, the Committee concentrates on the positive effects that developments in contemporary Japan are having on Australia and the opportunities they are creating for Australian business. It emphasises the ways in which Australia, in this changing world, can further consolidate and build on an already solid and friendly trading relationship with Japan.

7.2 The Committee has shown how the nature and composition of trade between Australia and Japan has changed over many years. Australian exports to Japan are no longer limited to strategic raw materials. The strong complementarity that existed from the very beginning of trade between the two countries continues to bind them and provides a solid platform on which both countries can strengthen their relationship. But alongside this established trading pattern, which is based on the exchange of predominantly primary products for manufactured goods, new trading links are developing. There is a reorientation of industry with the growing importance of information technology and, more importantly, services exports such as tourism. Wool, which secured the relationship during the post-war years, is no longer of such significance. Indeed, Japanese tourists are now more important as an export earner for Australia than the traditional wool exports to Japan.

7.3 In addition, the trading environment is changing. Japan's long period of rapid economic growth has come to an end. It is looking for ways to reinvigorate its economy; to encourage new industries. In seeking to lift its economy from the doldrums, Japan has embarked on an ambitious reform program which offers exciting prospects for new or expanding markets. Japan is restructuring its economic system and opportunities are emerging for Australia to broaden its trading horizons. Demographic and technological changes in Japan also present opportunities for new ventures.

1 'Restoration in Progress', A survey of business in Japan, *The Economist*, vol. 35, no. 8147, November 1999, p. 19.

Changes in the Japanese market place

Consumer preferences

7.4 Many witnesses appearing before the Committee drew attention to the noticeable shift in consumer preferences and trends in Japan in recent years. The elderly have become a significant consumer group, as have young women, and, despite the recent economic downturn, there has been, until very recently, a steady increase in income levels. There is a large and growing market for information technology and communication products across all age groups and strengthening consumer preference towards purchasing environmentally friendly products.²

7.5 The *Economist* summarised the extensive sweep of change in Japan:

Younger families want high-quality care for their elderly parents as the extended family breaks down. Parents want choice in education and health. Housebuyers want efficient estate agents and a wider selection of homes. Shoppers want out-of-town discount stores where they can drive with their kids. Women want small cars, better furniture, e-mail, and financial advisers they can trust. Japan is a nation of sleeping consumers.³

7.6 Australia's exporters are in a position to tap this large pool of potential buyers. The importance, however, of sound market research cannot be overstated. With competition fierce, it is important for exporters and investors to read the market accurately. Australians trying to sell into Japan are at a very great risk of missing the buyers' perspective, so they must pay close attention to the vagaries and peculiarities of the market if they want to maximise their potential in this still lucrative market.⁴

7.7 One of the most notable shifts in attitudes is toward a broader acceptance of new products. Japanese consumers who were traditionally 'blindly devoted' to locally made goods, now appreciate the value of imported ones. This willingness to consider new products opens the door for Australian exporters to Japan. Cheese, which is not a traditional part of Japanese culinary culture, is one of Australia's successes. In a period of economic stagnation there has been dramatic growth in exports of Australian cheese to Japan.⁵ In 1998, Australia, now a leading exporter of natural cheese to Japan, accounted for 40% of all Japanese cheese imports. According to a report

2 For example see: Queensland Government, submission no. 18, p. 3; Hiroshi Nakano, Japan Chamber of Commerce and Industry, Sydney Inc, *Committee Hansard*, 3 September 1999, pp. 789–80.

3 'Restoration in Progress', A survey of business in Japan, *The Economist*, vol. 35, no. 8147, November 1999, p. 19.

4 John Longworth, 'Understanding our customers: Hidden socio-political realities in Japan and China which influence trade with Australia', *Australasian Agribusiness Review*, vol. 1, no. 1, May 1993, pp. 25–6.

5 John Sainsbury, Department of Agriculture, Fisheries and Forestry, *Committee Hansard*, 28 May 1999, p. 662.

published in 1999, 'imports of Australian natural cheese for direct consumption will grow rapidly in the spring of 1999 and thereafter'.⁶

7.8 Mr Gregory Dodds, Executive General Manager, North East Asia Regional Office, Austrade, cited the selling of stockfeed to Japan as another example of changing attitudes towards, and a greater willingness to try, new products. He told the Committee:

People have been trying to sell molasses for a good number of years, and it has just been rejected outright by the Japanese as not being a stockfeed as far as they are concerned. At the beginning of this year, it became a stockfeed for a couple of Japanese. Why?...They have started to look at new ways of doing things and that pre-emptory arrogance that you would encounter in Japan a lot before is being replaced by cautious curiosity in many cases.⁷

7.9 Another example of changing approaches to foreign products and the growing receptiveness for things new comes from the banking sector. Up to a couple of years ago, it was unthinkable for the Japanese public to deposit their money into foreign banks but this is changing.⁸ Given this new found curiosity, the most careful attention, however, should be paid to Japanese preferences. Producers should be thoroughly familiar with the behaviour, sentiments and needs of the Japanese consumer together with the nature of the Japanese market. Cheese provides a good example. JETRO pointed out that 'while it is important to retain the traditional flavour of each nation's cheeses, it is also important to study the taste preferences of Japanese people and devote resources to developing products that accord with those tastes'.⁹

7.10 The challenge for Australian exporters is to entice the Japanese to experiment with a new or different product while winning their approval by meeting their particular taste requirements. The overriding message again is the importance of careful market research—in knowing your customer. Australian rice growers have shown the tenacity and perseverance required in researching and developing a product attractive to Japanese consumers. They have devoted time and resources to producing rice especially for the Japanese market.

7.11 Due largely to their determination, the market in Japan for Australian rice has grown from nothing five years ago to become a significant one. In 1995, Ricegrowers Co-operative Ltd launched a variety of rice called 'millin'—the first Australian bred variety to target the Japanese market. The breeding program for millin commenced in 1981, years before the opening of the Japanese market. This was followed in 1997 by the Japanese short grain variety koshihikari. In March 1999, Ricegrowers Co-

6 JETRO, *Japanese Market Report No. 30—Regulations & Practice—Cheese*, March 1999, p. 5.

7 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 635.

8 Hiroshi Nakano, JETRO, *Committee Hansard*, 3 September 1999, pp. 795–6, 798.

9 JETRO, *Japanese Market Report No. 30—Regulations & Practice—Cheese*, March 1999, p. 14.

operative launched the variety opus, which was the first Australian bred, short grain variety, resulting from a 12-year breeding program—again, started well before the commencement of rice imports into Japan. The Ricegrowers Co-operative Ltd told the Committee that it hopes to expand its exports of Australian short and medium grain japonica varieties to Japan.¹⁰

7.12 The Japanese consumer can be particularly fussy, for example, when choosing produce. Two matters—food safety and quality—are of primary importance to the Japanese. Witnesses could not overemphasise Japanese concern about safety considerations and surveys have repeatedly indicated that the Japanese consumer puts food safety at the top of the list. JETRO cited one such survey taken in 1997 that showed the main reason Japanese consumers shied away from imported produce was ‘concerns over safety.’¹¹

7.13 Moreover, the Japanese tend to regard the local product as safer than the imported one, so overseas exporters, as well as meeting regulatory standards, must also combat the strong bias favouring local goods. Exporters must convince a sceptical consumer of the safety of their product.¹² According to a JETRO report, ‘if overseas producers can reassure Japanese consumers of the safety of their products, they will have no difficulty selling them in Japan’.¹³

7.14 Close attention should also be given to labelling. Products offering assurances of safety, such as organic commodities, or products using only selected high-quality ingredients should be marketable.¹⁴ A strong brand name has strong selling power. Indeed, as part of establishing a name for safety and quality and to improve competitiveness a number of Australian industries are working to develop customer allegiance and to differentiate their product in the Japanese market from those of their rivals. This is one reason why the Australian Ricegrowers Co-operative is keen to develop branded sales to Japan.¹⁵ A brand name associated with safety and quality carries substantial weight in the market place. The Aussie Beef logo is one notable success.

10 Milton Bazley, Ricegrowers Co-operative Ltd, *Committee Hansard*, 17 May 1999, pp. 533–4. The NSW Department of Agriculture research station at Yanco developed the ‘opus’ rice variety with assistance from Ricegrowers Cooperative Ltd. Ricegrowers has supported the rice research and development activities of NSW Agriculture for more than 15 years, and it has contributed in excess of \$15 million to rice research over the period, pp. 534 and 542.

11 JETRO, *Japanese Market Report—Regulations & Practices—Fresh Vegetables*, No. 31, March 1999, p. 17.

12 John Sainsbury, Department of Agriculture, Fisheries and Forestry, *Committee Hansard*, 28 May 1999, p. 665.

13 JETRO, *Japanese Market Report—Regulations & Practices—Jam & Canned Fruit*, No. 32, March 1999, p. 17.

14 See for example JETRO, *Japanese Market Report—Regulations & Practices—Jam & Canned Fruit*, No. 32, March 1999, p. 17.

15 Milton Bazley, Ricegrowers Co-operative Ltd, *Committee Hansard*, 17 May 1999, pp. 534, 537.

Aussie Gold logo



7.15 Australia's beef exporters are an example of an industry that has paid close attention to Japanese sensitivities, especially in the area of health and safety and also of meeting Japanese expectations of quality through appearance and presentation. They recognise that, while improved access is important in a high income country such as Japan, consumer decisions as to the quantity of beef purchased are likely to be influenced by quality and safety issues. In most high-income countries, food accounts for only a fairly small part of the household budget. Most of the food bill is made up of the services that are embodied in the food—packaging, processing and advertising.¹⁶

7.16 This point about food safety was made clear in 1996 when, after many years of growth, beef consumption in Japan dropped by about 7% because of consumer concerns over Bovine Spongy Encephalitis (BSE) and particularly E Coli. The United States suffered a loss in Japan's market share.¹⁷ On the other hand, Australia has maintained its health and hygiene status, which is probably one of the biggest value differences that Australia is able to promote in the international market place.¹⁸

7.17 Australian beef exporters have also shown persistence in seeking improved access to Japanese markets and in their willingness to work with the Japanese to promote their product. They keep a watchful and anticipatory eye on their changing market in Japan. Australia was largely a grass-fed beef producer supplying product to a specification and a price. Once the market started to liberalise and customer-based

16 Paul Riethmuller, 'Major Trends Affecting Australia's Agricultural Industries: Have they Taken a Turn for the Worse?', *Economic Issues No. 3*, November 1998, p. 13.

17 Dr Peter Barnard, Meat and Livestock Association, Australia, *Committee Hansard*, 15 April 1999, p. 378.

18 Stephen Martyn, Australian Meat Council, *Committee Hansard*, 15 April 1999, p. 381.

preferences and demands started to come down the marketing chain directly to the producer in Australia, Australian beef exporters were able to adjust production and marketing processes to meet those new needs. The growth in grain-fed beef production demonstrated Australia's responsiveness to changing demands. The Meat and Livestock Association (MLA) believes that before liberalisation, it was about 3% of Australia's total production and has gone up to almost 40% of total production going to Japan, again reflecting customer demand in Japan.¹⁹

7.18 The downturn in Japan's economy has also caused a substantial shift in consumer demand. Over the last four or five years, there has been a broadening in the product mix of Australia's exports to Japan. Originally, beef exports were driven by the demand for high quality chilled beef but now, high quality manufacturing meat is a high growth area. Chilled grass-fed beef exports from Australia have dropped 6 percentage points and chilled grain-fed exports have also dropped, but frozen grass-fed exports have increased substantially, indicating a switch in Japanese consumer patterns, particularly at the lower end of food service. The fast food sector in Japan has grown and their dairy industry, which was a principal supplier of grinding meat in the past, has been unable to meet that demand. Australia has taken that over.²⁰

7.19 The MLA told the Committee that Japanese consumers are increasingly eating less within the home and noted especially the popularity of McDonald's, pointing out that about 80% of all McDonald's hamburger beef comes from Australia.²¹

7.20 The Australian beef exporting industry fully appreciates the importance of intelligent marketing and has reaped the dividends of successful promotional campaigns. Through the MLA and its predecessor, the industry has invested heavily in promoting Australian beef in Japan. Australian beef has won the confidence of Japanese consumers with quality and safety as its major selling points. The Aussie Beef brand is favourably perceived against United States' beef. Careful attention has been given to the presentation of beef in the shops and to the high standards of quality assurance.²² Again, the industry keeps in close touch with its customers needs and changing tastes.

7.21 The Australian Ricegrowers Co-operative Ltd is also very conscious of Australia's health and hygiene status, which places Australian produce at an advantage in the international market place. It understands Japanese concerns about quality and food safety and is working to meet these requirements. Indeed, Australian rice growers are setting very high standards. The Ricegrowers Co-operative explained that because of the crop rotation scheme in Australia, rice is relatively chemical free. Australian rice growers use about one-sixth the amount of agricultural chemicals and

19 Stephen Martyn, Australian Meat Council, *Committee Hansard*, 15 April 1999, p. 383.

20 Stephen Martyn, Australian Meat Council, *Committee Hansard*, 15 April 1999, p. 390.

21 Stephen Martyn, Australian Meat Council, and Samantha Jamieson, Meat and Livestock Australia, *Committee Hansard*, 15 April 1999, pp. 379–80.

22 Gary Humphries, Australia-Japan Foundation, *Committee Hansard*, 19 February 1999, p. 53.

fertilisers that the Japanese farmers use.²³ To underline this point, the Ricegrowers Co-operative submitted:

Japan, with its imports of rice, is currently testing rice for 104 different chemical residues. Certainly we are very proud of the fact that we are showing no detections on any of those residues that they are looking for.²⁴

7.22 The changes in the preferences of Japanese consumers are working to Australia's advantage but, as Australian beef producers and rice growers attest, a commitment and determination to meet the expectations of the Japanese consumer is essential in carving out a place in the Japanese market place.

7.23 Another significant characteristic of Japanese consumers is their keen appreciation for quality and service. Even though the Japanese may well be broadening their tastes, they nonetheless retain an 'impeccable sense of style'. Consumers' decisions are more likely to be swayed by issues such as quality and safety over price. Mr Christopher Pokarier told the Committee that while the Japanese take on board many Western things, they tend to do much better than the original product or process. He argued that Australians start way behind Japanese market expectations and have to go through a difficult learning process to satisfy Japanese standards of quality and performance.²⁵

7.24 Professor Coaldrake shared these sentiments. He believed that:

...the traditional arts have set what I would describe as subliminal standards of quality, industry, behaviour and organisation. One example: Japanese mirror-smooth surfaces on traditional lacquer boxes and bowls set a modern standard for automotive paint finish. The second example: the complicated interlocking wood joints which held historic buildings in Japan steady against earthquakes, storms and the centuries set a standard which explains why doors on Japanese cars do not leak and why there is no water dripping into the Sydney Harbour Tunnel.²⁶

7.25 He stressed that Australians need to be aware of these developments and to anticipate their effects on goods and services.²⁷ To succeed in Japan, Australian companies must be able to equal the standards the Japanese have set for themselves. They must appreciate the high level of quality control and be willing to alter product design and packaging to satisfy market requirements.

7.26 Put bluntly by Mr Terence White, Director, Australia-Japan Foundation based in Tokyo:

23 Milton Bazley, Ricegrowers Co-operative Ltd, *Committee Hansard*, 17 May 1999, p. 536.

24 Milton Bazley, Ricegrowers Co-operative Ltd, *Committee Hansard*, 17 May 1999, p. 541.

25 Christopher Pokarier, *Committee Hansard*, 16 April 1999, p. 434.

26 Professor William Coaldrake, *Committee Hansard*, 17 May 1999, p. 573.

27 Professor William Coaldrake, *Committee Hansard*, 17 May 1999, p. 573.

Japan is a place where, if you do not have the best product in the world, there is no real point in attempting to compete because they have the money, the purchasing power and the market size to be able to get the best thing in the world.²⁸

7.27 Mr White cited a number of examples where Australian products were meeting or expected to meet these high standards—the lighting decks in computers that control NHK’s halls around Japan; the seats likely to go into stadiums in Japan that will host the World cup and the design for drainage systems and watering control for natural grass stadiums.²⁹

7.28 Again, the Ricegrowers Co-operative demonstrated its understanding of Japanese appreciation for quality. It recognised that the Japanese will pay a premium for quality and asserted ‘that is exactly what we are supplying to them’.³⁰ Australian rice growers, however, were disappointed in early 1999 that they were being denied the opportunity to take advantage of supplying new season’s rice. Because of Australia’s counter seasonal advantage, Australian growers are able to supply new rice at old crop time in Japan. The Japanese look forward to eating new season’s rice but the Japan Food Agency, which controls the timing of tenders, had not given the new season’s advantage to Australian producers. With the way that the tenders are currently held and the timing for the tenders, Australia’s new season’s advantage is dramatically reduced.³¹ This situation was drawn to the attention of Japan in Australia’s submission to the Japanese Government on the Deregulation Promotion Program and needs to be followed up in Australian trade talks with Japan.³² Australian wheat growers are also fully aware of the benefits they derive from supplying Japan with a high quality product and are keen to maintain this reputation.

7.29 Even with the presentation of a product, the Japanese consumer is looking for the highest standards. Packaging, processing and advertising are an important aspect of marketing in Japan. JETRO, in its report on beer, noted that beer cans manufactured overseas generally have only one coating, while two coatings are normally applied in Japan. It stated that ‘even a slight unevenness of color or other minor blemish sometimes is reason enough for products to be returned’.³³

7.30 Although the Japanese are very particular about safety and quality, the recession has sharpened their appreciation of value for money. With continuing intense competition and deflationary expectations in the market, they are deferring some purchases or shopping with a selective eye for less expensive substitutes. They

28 Terence White, Australia-Japan Foundation, *Committee Hansard*, 19 February 1999, p. 46.

29 Terence White, Australia-Japan Foundation, *Committee Hansard*, 19 February 1999, p. 46.

30 Milton Bazley, Ricegrowers Co-operative Ltd, *Committee Hansard*, 17 May 1999, p. 535.

31 Milton Bazley, Ricegrowers Co-operative Ltd, *Committee Hansard*, 17 May 1999, p. 536.

32 Submission of the Australian Government to the Japanese Government on the Deregulation Promotion Program, see Appendix 4, p. 9.

33 JETRO, *Japanese Market Report—Regulations & Practices—Beer*, No. 23, December 1998, p. 15.

are prepared to accept a certain degree of cost cutting practices, for example, in less elaborate and expensive wrapping and the presentation of goods at the cash register. Without doubt, Japanese consumers are discerning and very canny—they are searching for products which give value for money.³⁴

7.31 This discernment is showing up in relation to certain top-of-the-line consumption-based goods. People are eating in less expensive restaurants and they are being more particular about the kinds of clothes they buy.³⁵ For example, the Australian crustacean market has been quite substantially affected over the past few years by the downturn in the Japanese economy. The decline of crustacean exports is around 22% to that market. The obvious markets to turn to as alternatives are other markets in Asia, which at the moment are not a good alternative.³⁶ The wool industry is another sector that is waiting for the Japanese economy to pick up in the hope that demand for the more expensive wool garment will increase.

7.32 The current recession, however, should not deter Australian exporters from exploring the potential of the Japanese market. Even if the economy shrinks, Japan remains a market of over one hundred million consumers with high disposable incomes.³⁷ The changing circumstances in Japan are creating opportunities but competition is strong and the Japanese market can be difficult. The need for Australian business to understand their customers better and to cater to a particular market cannot be underlined too strongly.

Demographic changes

7.33 Demographic changes in Japan may also provide an opportunity for increased exports of Australian products and services such as those targeted specifically to the elderly—provision of aged care, health care, recreation and leisure services.³⁸ Dr Carolyn Stevens pointed out that in 2025 the number of people requiring long-term care will triple. Therefore, extended and on-going care for bedridden and senile elderly people will become a critical issue in Japan.³⁹

7.34 The ageing population has not only to be cared for but also kept active, both mentally and physically. Their finances must also be managed. This consumer group with abundant savings is generating a strong and growing demand for services to meet

34 Christopher Pokarier, *Committee Hansard*, 16 April 1999, p. 423; Hiroshi Nakano, Japan External Trade Organisation, Sydney Inc, *Committee Hansard*, 3 September 1999, p. 788.

35 Janet Tomi, DFAT, *Committee Hansard*, 15 February 1999, p. 8.

36 Timothy Marney, Treasury Department of Western Australia, *Committee Hansard*, 25 February, pp. 160, 164.

37 See statement by Dr Craig Freedman, *Committee Hansard*, 15 April 1999, pp. 345–6.

38 Queensland Government, submission no. 18, p. 37.

39 Dr Carolyn Stevens, *Committee Hansard*, 17 May 1999, p. 570.

their specific needs. Health care, financial management or hobby services present new and exciting opportunities.⁴⁰

Changes in technology and increasing demand for financial services

7.35 The IT revolution also holds great promise as it expands and pushes into new fields. Business is embracing new technology and the application of IT technologies is spreading across a wider range of the Japanese economy, creating new opportunities in Japan for both foreign and domestic information and communications providers.⁴¹

7.36 Opportunities in areas such as the financial sector, particularly risk assessment, are being generated as the Big Bang reforms start to take effect. Financial services, which are inadequate in Japan, will provide openings for joint ventures. In the professional services area, the need for institutions and companies to benchmark against international standards and improve current practices has created a need for external consultancy services, and this demand will accelerate as deregulation continues in Japan. The door is open for Australian consultancy businesses especially in the area of financial services.⁴² Mr Tadashi Nakamae told an OECD Business and Industry Policy Forum:

Japanese banks and insurance companies are still woefully inefficient, and huge potential exists for financial products that offer Japanese savers a viable alternative to bank deposits. With the interest rate on bank deposits now set at zero, savers are naturally reluctant to put more of their money into the bank. Investment trusts are likely to emerge as the main alternative, but the investment trusts on offer at present, those controlled by Japan's big financial institutions, are not a good investment. When genuine competition is introduced to the investment fund management business, the yield of investment trusts may rise to 5–10%. Then the asset management market will expand rapidly, at the expense of bank deposits.⁴³

7.37 JETRO pointed out that the enormous individual financial assets of the Japanese, estimated at over ¥1.2 quadrillion in value, holds significant appeal for overseas financial institutions. The economic difficulties and the need for corporate restructuring will continue to offer unprecedented opportunities for foreign financial

40 Hiroshi Nakano, Japan External Trade Organisation, *Committee Hansard*, 3 September 1999, p. 788. See also BT Funds Management Limited, Newsletter, *Cherry Picking in Japan*, February, 2000.

41 Professor Peter Drysdale, *Committee Hansard*, 23 August 1999, p. 767.

42 For example see Professor David Allen, *Committee Hansard*, 25 February 1999, p. 181; Dr Craig Freedman, *Committee Hansard*, 15 April 1999, p. 350; Perce Butterworth, New South Wales Department of State and Regional Development, *Committee Hansard*, 15 April 1999, p. 394.

43 Mr Tadashi Nakamae, President, Nakamae International Economic Research, Presentation for the OECD Business and Industry Policy Forum on 'Realising the Potential of the Service Economy: Facilitating Growth, Innovation and Competition', Paris, 28 September 1999, p. 2.

institutions ‘to move into Japan and develop financial services products without hindrance’.⁴⁴

7.38 Overall, the major growth areas in Japan are in medicine and welfare, information and telecommunications, and distribution and logistics. Housing also appears promising.⁴⁵

7.39 The first step to success in the Japanese market is to identify niches where Australian firms have the resources or expertise to secure a foothold. The task of both the business community and the government is to recognise these opportunities and determine how best to capitalise on them.

7.40 Prevailing economic conditions, changes in consumer preferences, the importance of the environment and Japan’s ageing population may provide new market opportunities but they may also harm Australian exports to Japan. The decline in demand for wool and in crustaceans by the Japanese as well as the fall in coal prices reflects the economic downturn. So, it is important for both established and potential exporters to Japan to monitor and accurately assess trends and changes in Japan.

7.41 The overriding message is that Australian business and the Australian Government must be well informed about developments in Japan and be able to analyse such developments to anticipate trends accurately and to identify opportunities.

The Japanese economy—reform, restructuring and opportunities

Reform and deregulation

7.42 The Japanese market offers opportunities for Australian exporters but innovation and careful market research will not necessarily bring success. Importantly, Japan still has in place some hefty obstacles to trade. In the previous chapter, the Committee looked at the tariff and quota system that controls the imports of products such as rice, sugar and beef. But in addition to these barriers, there is also a raft of rules and regulations clogging the economic system. Administrative and regulatory bottlenecks have for many years either created difficulties for, or even discouraged, Australian companies from doing business in Japan.

7.43 Recently, Japan has begun to dismantle some of its barriers to trade. The OECD acknowledged the work being done in Japan:

Tremendous effort has produced real progress in reducing economic intervention in many sectors, among them, large retail stores, gasoline imports, telecommunications, and financial services...There is slow but steady movement toward more transparent and less discretionary regulatory

44 JETRO, *The Changing Service Industries of Japan*, Tokyo, 2000, p. 2.

45 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 641.

practices, partly driven by market demands and partly by recognition of the gap between traditional and international practices. The competition policy framework is stronger. Several initiatives underway to promote the use of international standards will help expand trade flows, to the benefit of Japan's consumers.⁴⁶

7.44 Japan's reform program has already greatly assisted Australian exporters. The liberalisation of Japan's processed food imports has facilitated large-scale exports of Australian dairy products and has made investing in Japan easier and less expensive.⁴⁷ The Committee has shown the benefits that Australian beef and rice exporters have derived from a freeing up of the Japanese market but more work needs to be done in this area.

7.45 Even though Japan has been chipping away at its barriers to trade, difficult hurdles still remain for producers trying to sell their product in Japan. The first obstacle is at Japan's front gate with its tariffs, quota requirements and quarantine regulations.

7.46 With the conclusion of the Uruguay Round Agreement in December 1993, a number of sensitive issues surrounding the access of agricultural and food products were resolved. The Agreement recognised the right of members to take sanitary and phytosanitary measures necessary to protect human, animal or plant life from imported goods provided that such steps were founded on scientific principles. Members were to base their regulations on international standards, guidelines or recommendations, where they existed.⁴⁸

7.47 The Department of Agriculture, Fisheries and Forestry accepted that the harmonisation of international standards was a slow process because of the need for scientific evaluation. It acknowledged that the Japanese processes were basically consistent with the WTO, but they moved very slowly:

We certainly have concerns that some of the processes are not sufficiently quick and timely to ensure that the rights of Japan's trading partners are properly taken into account.

...

...we have succeeded in obtaining new access for Tasmanian Fuji apples and also for easy peel citrus. The processes involved in achieving that access took a long, long period of time. I would be hard-pressed to justify

46 Organisation for Economic Co-operation and Development, *Regulatory Reform in Japan*, OECD, Paris, 1999, p. 15.

47 DFAT, submission no. 32, p. 64.

48 See Articles 2 and 3, 'Agreement on the Application of Sanitary and Phytosanitary Measures' in Agreement Establishing the World Trade Organization.

the long process in terms of the difficult science, and so forth that was involved.⁴⁹

7.48 The issue of obtaining access for Tasmanian Fuji apples and the Japanese concern over fire blight had been around for at least 10 or 15 years before it was finally resolved. Once the Uruguay Round was passed and Japan amended its plant quarantine laws, the path was cleared for the importation of these apples. The first shipment of Tasmanian Fuji apples reached Japan for sale in June 1999.⁵⁰ The Department of Agriculture noted that after the successful conclusion of the Uruguay Round:

...there was certainly a clear indication that the process of proceeding with applications for lifting of quarantine barriers did become more transparent and did speed up quite significantly. Prior to the Uruguay Round it was very unsatisfactory, very slow and obviously used as a trade protection barrier. But following the Uruguay Round there has certainly been a clear indication to us on some of our access issues that there has been far better progress.⁵¹

7.49 Easy peel citrus fruit is another example of where a breakthrough in quarantine requirements has allowed the export of mandarins to Japan. Again, after years of negotiation, the Japanese Government finally in 1999 accepted the efficacy of Australian quarantine treatment for fruit fly.⁵²

7.50 The Japanese are not alone in applying regulations to control imports and, like many countries, still has a long way to go before they adopt regulations that harmonise with international standards, for example, in the food safety area. But, despite the liberalisation measures already taken, a wide variety of implicit trade barriers prevent agricultural and food imports from entering Japan.⁵³

7.51 The Australian Government is working on a number of fronts to encourage Japan to liberalise its trade. In the previous chapter, the Committee noted the importance of Australia's involvement in fora such as APEC and the WTO. There is also much scope for Australia to improve trade flows between Australia and Japan through bilateral negotiations.

49 John Sainsbury and Dennis Gebbie, Department of Agriculture, Fisheries and Forestry, *Committee Hansard*, 28 May 1999, p. 665.

50 Media Release, Judith Troeth, Parliamentary Secretary to the Minister for Agriculture, Fisheries and Forestry, AFFA99/62T, 16 June 1999.

51 John Sainsbury, Department of Agriculture, Fisheries and Forestry, *Committee Hansard*, 28 May 1999, p. 665.

52 Department of Foreign Affairs and Trade, Japan, 'Ripe Future for Mandarin Exports to Japan', 15 July 1999. There are a number of examples of further breakthroughs in quarantine regulations. See Media Release, Mark Vaile, Trade Minister, 'Citrus juice exports to Japan set to grow', 26 August 1999.

53 John Sainsbury and Dr Dennis Gebbie, Department of Agriculture, Fisheries and Forestry, *Committee Hansard*, 28 May 1999, p. 665.

7.52 The Australian Government's strategy through the Supermarket to Asia Council is one way of facilitating trade, especially in expediting some of the processes in clearing products through customs. Under this strategy, the government seeks to provide enhanced opportunity for cooperative resolution of sanitary and phytosanitary issues with Japan. To encourage Japan to accelerate the process of making its quarantine and food standards consistent with its international obligations under the WTO Agreement on Sanitary and Phytosanitary Measures, the government has placed technically qualified plant science and veterinary counsellors in the Australian embassies in Tokyo and Seoul.

7.53 There are also regular bilateral quarantine discussions. The Department of Agriculture believed that these consultations contribute to broadening and deepening the overall bilateral agricultural relationship. It is also working hard under the auspices of the Australia-Japan Ministerial Committee and the so-called partnership agenda developed under that Committee to improve Australia's overall agricultural policy dialogue at a high level with Japan. It concedes that there is still some way to go before achieving the full implementation of the commitments of both governments towards enhancing that policy dialogue.⁵⁴

7.54 The Australian Government can assist exporters in bilateral trade negotiations where a change in rules or regulations will allow the exporter to benefit from a comparative advantage. As an example, and already noted by the Committee, Australian rice growers, who are able to produce new rice out of season, would enjoy a distinct advantage if the government tendering process in Japan was conducted at a time that allowed Australian new rice to be sold in the Japanese market. This is a matter likely to be resolved at a government-to-government level.

7.55 The recent successes of improved or new access to the Japanese market—Fuji apples and easy peel citrus fruit—augured well for a further opening of the Japanese market. But according to the Department of Agriculture, Japan's agricultural sector remains highly protected and is expected to remain so without significant international pressure.⁵⁵

7.56 Australia is also actively involved with the Japanese Government's deregulation action plan. It made a submission in December 1994 outlining regulatory issues that either directly or indirectly affected Australian access to Japan's markets. The emphasis was on diversifying Australian exports towards new items such as apples, melons, mangoes and citrus.⁵⁶ It also provided a submission in 1998 for the first revisions to the Japanese Deregulation Promotion Program (1998–2000). This

54 Dr Dennis Gebbie, Department of Agriculture, Fisheries and Forestry, *Committee Hansard*, 28 May 1999, p. 659.

55 Dr Dennis Gebbie, Department of Agriculture, Fisheries and Forestry, *Committee Hansard*, 28 May 1999, p. 660.

56 Jamie Anderson, 'Australia's Market Access Agenda Towards Japan', *Pacific Economic Papers*, no. 291, Australia-Japan Research Centre, May 1999, p. 11.

submission highlighted particular problems for Australian exporters and put forward proposals for deregulation in sectors such as housing and construction; telecommunications; agricultural products; legal and financial services; and fast ferries.⁵⁷ (See Appendix 4)

7.57 One of the areas singled out for attention in Australia's submission involved steel-framed housing. Again, one of the main difficulties faced by Australian business in this highly regulated market was the slow-moving bureaucracy and the time and effort required to obtain approval of standards already accepted in Australia.⁵⁸ In its submission, the Australian Government pointed out to the Japanese Government that 'Many Australian companies are using new, innovative steel technologies which allow for much lower thicknesses but exhibit the strength and quality characteristics of much thicker steel.'⁵⁹ Austrade told the Committee that it had spent the last few years seeking Japanese approval for steel framed housing. In April 1999, approval for this steel technology was finally given after eighteen months of consultations and tests and at a cost to Australian business seeking this approval of about \$5 million.⁶⁰

7.58 Lack of information on the details of Japanese building and product standards, codes, rules, regulations and costs also frustrate the efforts of Australian housing companies to move ahead in Japan. Mr Graham Huxley, a representative of Australia Japan Housing Ltd, told the Committee that their main objective, for which they would like funding, is to produce an annual report detailing building costs in Japan. He stated that they wanted to:

...provide members with a document that sets out building materials, labour rates and building costs in Japan for different levels of builders...so that, when builders or building materials manufacturers from Australia go up there, they can look at that document and get an idea of what they are competing with. To get that information is virtually impossible.⁶¹

7.59 Austrade agreed that companies, such as those in the building industry, experience difficulties in trying to establish themselves in Japan. It believed that Australian companies needed to develop a more certain presence in the market than existed at the moment. It also noted that those that had made a start in Japan were quite small companies with limited capacity to push to exploit their gains.⁶²

57 Submission of the Australian Government to the Japanese Government on the Deregulation Promotion Program, 1998, http://www.dfat.gov.au/geo/na/japan/981106_japan_deregulate.pdf (8 February 1999).

58 Graham Huxley, Australia Japan Housing Ltd, *Committee Hansard*, 15 April 1999, p. 361. See also statement by Philip Henry, Department of State, Queensland, *Committee Hansard*, 16 April 1999, p. 419.

59 Submission of the Australian Government to the Japanese Government on the Deregulation Promotion Program.

60 Graham Huxley, Japan Australia Housing Ltd, *Committee Hansard*, 15 April 1999, pp. 359–60.

61 Graham Huxley, Australia Japan Housing Ltd, *Committee Hansard*, 15 April 1999, p. 366.

62 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, pp. 637–8.

7.60 Even so, these small companies are determined to persevere. Japan Housing Ltd made the point forcefully that to succeed in Japan, business must be prepared to be patient and to persist with a long-term commitment to establish themselves as a viable business. While acknowledging that the housing market potential in Japan is 'huge', Mr Huxley stressed that it was not for the 'faint-hearted'.⁶³ In underlining this point and referring to the government's withdrawal of funds to support a secretariat for Japan Australia Housing Ltd, he told the Committee:

That is why we would urge government not to get cold feet and pull the plug on us. We need help. It took the Yanks 30 years to get to the level they are. We have only been there five years.⁶⁴

7.61 The Committee is not in a position to judge the merits of this particular case on funding but it does take the opportunity to underline the difficulties faced by companies, particularly smaller businesses, in establishing themselves in Japan and the importance for the Australian Government to take a longer term view in giving support to these companies.

7.62 It also wishes to draw attention to the Committee's report on APEC, which showed that Australia is taking a prominent role in the area of trade facilitation, particularly in the harmonisation of standards and conformance procedures in the Asia Pacific region. The report drew special attention to and commended the work of CSIRO and the National Association of Testing Authorities, Australia.

7.63 The Committee recognises the efforts of the Australian Government at a bilateral level to further liberalise trade and investment with Japan and to facilitate trade between the two countries. It notes the successes that have been achieved in improving market access but, nonetheless, accepts that there is much more to be done.

Recommendation

The Committee recommends that the Australian Government continue to work with Japan through various programs, including the Supermarket to Asia Council and through Japan's Deregulation Promotion Program, to facilitate trade between the two countries.

7.64 The Committee took special note of the difficulties experienced by Australian companies in obtaining information about Japanese standards and in obtaining official approval for products that already meet Australian standards. Testing and performance

63 Graham Huxley, Australia Japan Housing Ltd, *Committee Hansard*, 15 April 1999, pp. 360, 375. See also Australia Japan Housing Ltd, submission no. 6, p. 3.

64 Graham Huxley, Australia Japan Housing Ltd, *Committee Hansard*, 15 April 1999, p. 376. Also see comments on p. 368.

barriers are particularly severe for small and medium-sized enterprises with their small economies of scale and limited ability to absorb extra costs.

Recommendation

The Committee recommends that the Government persist with its efforts to harmonise standards and conformance procedures with Japan bilaterally and throughout the region.

Distribution system

7.65 One of the main disincentives for people considering selling their product in Japan is the distribution system. Having successfully overcome tariff or quota restrictions and satisfied quarantine, health, safety and other technical standards, exporters may find the prospect of selling their goods in Japan simply too daunting. Japan's complicated distribution chains have long frustrated foreign exporters, who see the web of relationships making up the distribution system as a formidable obstacle to trade. Evidence suggests that barriers to competition seem to restrict market access more in Japan than elsewhere.⁶⁵ The Commission of the European Communities best described the situation:

Newcomers and foreign companies tend to encounter particular difficulties in penetrating the Japanese distribution system. The existence of long-term exclusive or semi-exclusive relationships between established Japanese manufacturers, wholesalers and retailers makes it difficult for merchandise products from alternative suppliers to enter into the distribution network. Analogous difficulties exist in the case of various service industries.⁶⁶

7.66 A number of witnesses raised the matter of non-tariff barriers, saying that Japan still has some very serious impediments to trade, both visible and invisible. The limited sales of Australian-made fast ferries strongly suggest that a number of invisible barriers to imports of sophisticated manufactures are operating in Japan. Dr Mark Beeson argued that, because of the structure of corporate relationships in Japan, there is absolutely no interest in buying fast ferries from outside Japan if they can buy them from another corporate grouping. This is so even if the price is greater than they would pay for the Australian product and the quality of the product is slightly inferior to the Australian one. He told the Committee:

There are a number of barriers like regulations, red tape and corporate relationships that are not always visible things but systematically work

65 Austrade, submission no. 35, p. 9. See also Jonathan Coppel and Martine Durand, 'Trends in Market Openness', *Economics Department Working Paper no. 221*, Organisation for Economic Co-operation and Development, August 1999, p. 5.

66 Commission of the European Communities, *List of EU Deregulation Proposals for Japan*, 12 October 1998, p. 8.

against Australian exporters being able to supply increasing amounts of goods into Japan, even if they produce the sorts of goods that Japan actually wants to buy.⁶⁷

7.67 Impediments to competition in Japan, nonetheless, are being dismantled and, as noted by the Committee in Chapter 4, even ‘the buy Japan policy’ is being undermined. Over the years, distribution options have increased and foreign products are becoming increasingly acceptable.⁶⁸ Not only are Japanese consumers more receptive to new products and Japanese business to new ideas but also the ability to sell goods and services in Japan has improved with changes in access rules and in the distribution system in Japan.

7.68 Japan, however, still retains its forbidding reputation as a difficult market in which to do business. Securing a foothold in Japan is a matter of having the know-how and the right connections.⁶⁹ For many years, advice for exporters to Japan centred on the need to establish close personal relationships with Japanese agents and, where possible, customers.⁷⁰ Many experts advised that people seeking to enter the Japanese market should arrange tie-ups with Japanese agents or form partnerships with Japanese companies for the distribution and sale of their product.⁷¹ Food and agricultural industries in Australia are increasingly linking up with foreign firms or organisations. The establishment in 1997 of a joint venture company between the Australian Wheat Board and Zennoh to market feed grains in Japan is an example of the type of arrangement that is becoming increasingly common. The Australian Dairy Corporation has designated Mitsubishi Corporation, Tomen Corporation, Toshoku Ltd and Mitsui & Co. Ltd as its sole import agents. The Ricegrowers Co-operative Ltd has formed a joint venture with Mitsuhashi Inc.⁷²

7.69 The tie-ups that are being established between producers in Australia and Japanese consumer cooperatives to market horticultural products and livestock products in Japan, although on a much smaller scale, have the potential for growth. These linkages are important for Australian companies because they provide an

67 Dr Mark Beeson, *Committee Hansard*, 16 April 1999, pp. 482–3.

68 DFAT, submission no. 32, pp. 21–3.

69 Professor Teresa Morris-Suzuki, *Committee Hansard*, 24 May 1999, p. 606.

70 For example see Australian Department of Trade, ‘Persistence, Performance and Price’, *Report of the Japanese Market Access Promotion Mission to Australia, November 1984*, AGPS, Canberra, 1985, pp.16–17.

71 JETRO, *Japanese Market Report—Regulations & Practices—Cheese*, No. 30, March 1999, p. 9; see also advice offered in JETRO Reports, no. 10, p, 13; no. 15, p. 23; no. 23, p.19.

72 See Paul Riethmuller, ‘Major Trends Affecting Australia’s Agricultural Industries: Have they Taken a Turn for the Worse?’, *Economic Issues* no. 3, Department of Economics, the University of Queensland, November 1998, pp. 14—15.

established distribution network and a means of obtaining specialised knowledge on the particular requirements of Japanese consumers.⁷³

7.70 There are compelling reasons for Australian producers to seek out the assistance of Japanese agents to help market their products in Japan. But there can be significant disadvantages. The coal industry highlights this problem. Japanese companies, through Japanese trading agents, have a strategic and weighty presence in the marketing of commodities such as coal. This has both a positive and negative aspect for the Australian producer. QCT Resources noted that when it comes to knowledge of Japanese markets, the hand of Australian exporters is held tightly by Japanese trading agents who assist in Japan. The agents, however, are not only assisting Australian exporters but are very close to Japanese industry. QCT Resources explained:

There is no doubt that in the relationships and in the negotiation process we have relied very heavily on the Japan partner in the negotiation. Anybody contemplating entry into Japan cannot do it unless they have a close Japanese partner that is credible and financially stable.⁷⁴

7.71 The NSW Minerals Council also commented on the issue of Japan's trading agents and the possible control of the coal market by Japanese customers. It made clear that the Japanese steel mills and power utilities are not major investors in the Australian coal industry. Further, while they have a certain share in the industry, the Americans, the British, and other European countries have a far more significant investment in the industry than the Japanese customers. It concluded:

The trading houses do have a certain stake in the industry, but I think we can be misled by the fact that there is a high proportion of overseas ownership in the coal industry and by then tying that to some sort of price manipulation.⁷⁵

7.72 The Council also responded to the proposition of introducing a collective approach to coal marketing and pricing. It told the Committee that this would be 'a highly dangerous approach and not appropriate'. In pointing out that the negotiation process for fixing a coal price was very complicated and that there were no simple answers, the Council suggested that the weight of evidence indicated that trying to form seller cartels is a 'very dangerous way to go'. It argued that the customer can place a very different interpretation on the move to a collective approach. If Japanese coal buyers saw their major coal supplier, Australia, trying to form a collective approach, 'that would have a major impact on the way they went about their business,

73 Paul Riethmuller, 'Major Trends Affecting Australia's Agricultural Industries: Have they Taken a Turn for the Worse?', *Economic Issues* No. 3, November 1998, pp. 14–15.

74 Dr Christopher Rawlings, QCT Resources Ltd, *Committee Hansard*, 16 April 1999, p. 491.

75 Denis Porter, New South Wales Minerals Council, *Committee Hansard*, 14 April 1999, p. 272.

in terms of where they bought their coal and in terms of what share coal would get in Japan as opposed to gas, nuclear and so on'.⁷⁶

7.73 Dr Rawlings went further to note that Australia is not the only supplier of coking coal which also comes from Canada, and the United States and some soft coking coal from Indonesia. He stressed:

...we are not the only country in the world that does have resources in the ground waiting to be developed. I must admit that when I hear talks of, or consideration being given to, there being some ability to control this industry the first thing the Japanese will do is use their considerable financial muscle to invest in another coal resource somewhere else and compete against us...there are very clear reactions to the concept of control and intervention that the Japanese have had a history of being able to implement.⁷⁷

7.74 This tension between Australian commodity producers and Japanese customers came to the fore in July and early August 2000 when Rio Tinto launched an aggressive hostile takeover bid for rival mining group North Ltd. Fearing that their negotiating position could be weakened and that Rio would dominate the iron ore industry in Australia, North's Japanese partners—Nippon Steel Corp, Mitsui and Co. and Sumitomo Metal Industries Ltd—strongly opposed the bid. In an attempt to prevent the concentration of control of the iron ore industry in Australia, the Japanese steel mills retaliated by supporting Anglo American's counter move to takeover North.⁷⁸ If successful, this arrangement would keep a third supplier of iron ore in Australia. As economic journalists Ian Howarth and Andrew Cornell explained:

The fight for control of North has triggered a critical battle over Japanese steel producers' historic power to divide and rule among Australia's key suppliers of coal and iron ore.

The steel Cartel see Rio's bid for North as a threat to the survival of the Japanese steel sector, long a protected industry, in its current state.

The Japanese want at least three major iron ore exporters in the Pilbara region of Western Australia.

They are concerned that rationalisation would reduce their ability to play Australian producers off against one another in negotiations on price.⁷⁹

76 Denis Porter, New South Wales Minerals Council, *Committee Hansard*, 14 April 1999, p. 274.

77 Dr Christopher Rawlings, QCT Resources Ltd, *Committee Hansard*, 16 April 1999, pp. 490–1.

78 See David Uren, *Weekend Australian*, 29–30 July 2000, p. 42; Andrew Cornell, Tokyo, *Australian Financial Review*, 19 July 2000, p. 15, 24 July 2000, p. 1 and 13, 27 July 2000, p. 11, 1 August 2000, p. 18; Stewart Oldfield, *Australian Financial Review*, 4 August 2000, p. 46; Jane Counsel, *Sydney Morning Herald*, 4 August 2000.

79 Ian Howarth and Andrew Cornell, Tokyo, 'Cartel wars: Rio targets Japanese in North battle', *Australian Financial Review*, 26 July 2000, p. 1.

7.75 This struggle between Rio and the Japanese mills underlines Japan's desire to maintain its strong position as a buyer and to exercise significant control over Australian iron ore prices.⁸⁰ Clearly, Rio's move to take over a major competitor and supplier of iron ore to Japan has sparked a strong and angry reaction from the Japanese steel cartel.

7.76 A different situation has developed with LNG producers. The Australian LNG industry, in looking for better ways to market its product, is considering multimarketing and diversifying its markets and getting away from the single one-to-one with its product to Japan. According to Woodside, the Japanese buyers seem to appreciate the gas industry's need to reassess its marketing strategy. Nonetheless, Woodside remains very aware of the valuable trading relationship that has grown up between Australia and Japan. It made clear that it is keen to ensure that if their Japanese customers require parts of its project to be dedicated to them, then the longstanding relationship it has with them will continue. Woodside told the Committee:

...we are also looking at innovative ways to market LNG elsewhere. There is a major push on now to present Australian LNG projects with a single face so that confusion in the market place...can be mitigated and reduced and we can present a united front and then worry about which project here produces the LNG.⁸¹

7.77 Witnesses also raised concerns about the extent of Japanese involvement in the marketing and selling of beef in Japan. Dr Mark Beeson argued that when the imports of beef into Japan increased, Japanese corporations responded by immediately moving into Australia where they bought up 'every aspect of the industry in Australia and between Australia and Japan'. He argued:

Japanese corporations basically control the whole beef producing industry from the farm gate to the supermarket shelf. This means that Japanese corporations can shift profits up and down the value production line. They can realise profits in Japan so that Australian producers, the people who actually grow beef, get very little for their product. The profits are realised back in Japan.

...

...it is transfer pricing, and the Japanese corporations are very good at this.⁸²

80 Andrew Cornell wrote an interesting article on the nature of Japan's steel cartel, 'The family nature of Japan's steel cartel', *Australian Financial Review*, 31 July 2000, p. 8.

81 Erica Smyth, Woodside Energy Ltd, *Committee Hansard*, 25 February 1999, p. 207.

82 Dr Mark Beeson, *Committee Hansard*, 16 April 1999, p. 487.

7.78 The Queensland Government expressed similar worries about the Japanese involvement in the beef industry, particularly this practice of price transferring. It submitted:

Several Japanese companies have invested heavily in Queensland abattoirs and cattle properties. Most of the production from these facilities is exported unprocessed to Japan. However, many of these businesses are run at a loss in Queensland with the value-adding and packaging of the product done in Japan.

The bulk of profits in the beef sector are generated by the wholesale marketing chain in Japan. Raw product is supplied into Japan by Queensland but Queensland producers and abattoirs cannot maximise their margins and receive premium prices without value-adding and packaging beef products in Queensland. Therefore, there is a need for Queensland beef to be value-added and pre-packaged in Australia before it is exported to Japan.⁸³

7.79 The current tight economic situation in Japan means that the temptation to shift profits back to Japan is greater. The trading company's first loyalty or primary instinct is to pass the burden on to their suppliers by exerting downward pressure on prices; for example, falls in the negotiated price for iron ore and coal earlier in 1999. Mr Dodds argued that, if the trading companies are too successful in placing the economic squeeze on Australian producers, they will defer some hard decisions that they have to make about their own structuring and behaviour and will be passing on the costs of their own inefficient management to Australian suppliers.⁸⁴

7.80 At the moment, Japanese trading companies occupy a central position in Australia's trading activities with Japan and are reluctant to relinquish their influence. Austrade pointed out that these companies carry just over two-thirds of Australia's total exports to Japan. It submitted that they seek to place themselves strategically in the trading spectrum—they will occupy and control the ground at all stages onward from the quarry or farm gate. Moreover, they encourage Australian companies to assume that marketing in Japan is too hard—and to a degree they have succeeded. Mr Dodds told the Committee that Japan has the largely well deserved image of being a difficult market to work in. So that while Australian companies are prepared to invest in places like China and Vietnam, which are also difficult markets, Japan has 'most people spooked'. According to Mr Dodds, Australian companies are prepared to leave business to the trading companies.⁸⁵

7.81 Clearly, Australian producers rely heavily on Japanese companies to market their product. This close association brings both advantages and disadvantages for Australian producers. It allows them to benefit from the expertise, local knowledge

83 Queensland Government, submission no. 18, p. 34.

84 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 629.

85 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 632.

and the business contacts that Japanese companies bring to the relationship. On the other hand, a Japanese agent, especially one of the large trading companies, can close the Australian producer out of key strategic positions in the production and distribution loop and manipulate the market.

7.82 There are important and fundamental changes, however, taking place in the modes of retailing, marketing and distribution in Japan that should encourage Australian businesses to reassess their marketing strategy. The process of deregulation has made inroads into the established distribution network. The easing of the Large-Scale Retail Store Law, for example, has encouraged larger, more efficient retail outlets.⁸⁶ The corner store is being replaced by major retailers and consortiums.

7.83 The recession has accelerated the pace of restructuring. As explained in Chapter 3, the downturn in the economy has intensified competition in the market place with price conscious consumers diligently comparing prices and producers looking keenly to cut production costs. The search for value for money is increasing downward pressure on prices. As business conditions continue to tighten, there has been a growing urgency to simplify the distribution channels.⁸⁷ Developments such as the increasing popularity of supermarkets and convenience stores, the rapid growth of discounting, and associated direct importing; the emergence of regional markets; the beginnings of an organic food market, and the entrance of foreign companies into the Japanese market are dramatically redefining the way goods are distributed and sold in Japan.

7.84 The gradual collapse of the traditional multi-layer distribution systems creates its own momentum.⁸⁸ The informal cartels within Japan and cross-shareholding, which have made it very difficult for outsiders to secure a presence in the system, are now breaking down. The growing prevalence of larger retailers and wholesalers has meant that they have been able to shoulder their way into the distribution system, increasing their influence at the expense of manufacturers and trading companies. According to Austrade, this growing involvement of large retailers and wholesalers in the distribution chain has:

...further weakened the relationships between firms that had traditionally held a tight grip on their respective markets and allowed foreign suppliers

86 JETRO explained that the Large-Scale Retail Store Law was amended in January 1992 to ease many of the regulations that made it difficult to open large stores. The law has been amended on successive occasions but as of June 2000 will be replaced by a newly enacted Large-Scale Retail Store Location Law. It stated 'Of all the various deregulation policies currently being implemented, it has been among the first sectors to undergo significant change and to have a significant impact on the lives of ordinary people.' JETRO, *The Changing Service Industries of Japan*, JETRO, 2000, p. 15.

87 Hiroshi Nakano, Japan External Trade Organisation, Sydney Inc, *Committee Hansard*, 3 September 1999, p. 788.

88 Austrade, submission no. 35, p. 63.

able to deal directly with retailers or major wholesalers to extract greater profit for themselves from the value chain.⁸⁹

7.85 The practice of smaller companies exercising choice is also loosening the hold of the Japanese trading companies on trade in Japan. Austrade observed:

We are seeing ordinary companies in the Japanese market beginning to change their own purchasing policies in increasing numbers. By that I mean that they are buying directly more and more. They are quite capable of doing it. It is just that the trading companies have successfully manipulated this relationship and now, under recessionary pressures, it is hard to keep that game going.⁹⁰

7.86 The credit squeeze is also forcing the trading companies to release their grip on strategic positions in the trading system in Japan. Japanese trading companies are no longer able to supply export finance at attractive rates on a long-term basis. In Austrade's words, 'their ability to retain that position in the middle as the necessary link between Japanese buyers in Japan and foreign suppliers—a position that they have been very successful at keeping over the past decades—is now coming under real pressure'.⁹¹

7.87 Austrade was concerned that Australian companies could miss out on opportunities to capitalise on the changes taking place in the Japanese trading companies. Mr Greg Dodds told the Committee that he knew of examples of Australian companies, on their own initiative, breaking off their established trading company relationships and selling directly to retailers in Japan. They had chosen to market their products using either a retail brand or an Australian brand. Austrade pointed out that often they decided to mix the labelling—the supermarket chain would obviously brand the product as its own product but the supply from Australia would be a high point.⁹²

7.88 Austrade also pointed out the possibility of one or more of the large trading companies failing and the immediate difficulty that Australian companies relying on that company for their access to the Japanese market would face. It warned companies to be aware of their vulnerability should their Japanese trading company experience financial difficulties or even close its doors.⁹³

7.89 Also of concern to Australia is the number of mergers and acquisitions taking place in Japan. If a buyer of Australian products or a company that has investments in Australia is taken over by an overseas company, there is no certainty that it will

89 Austrade, submission no. 35, p. 63.

90 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 633.

91 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 629.

92 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 634.

93 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 630.

continue to use Australian goods or to invest here. According to Austrade, ‘...there is a distinct possibility that, for their own strategic reasons, they would shift their sourcing to, say, Canada, the US or so on’.⁹⁴ The most recent speculation about a withdrawal from the automobile manufacturing industry in Australia by Mitsubishi after its takeover by DaimlerChrysler highlights the importance of Japanese investment in Australia.

7.90 The slowdown in the Japanese economy may work to the advantage of Australian exporters seeking to improve or increase their involvement in the development and marketing of their product. Austrade believes that a recessionary environment is a good one in which to conduct business in Japan and to present fresh ideas and push new products. According to Austrade, trading with the Japanese during good times is strictly on their terms. During times of economic uncertainty, however, when they are under pressure, they will seriously consider alternatives.⁹⁵

7.91 The Committee believes that Australian exporters should take this opportunity to reassess their business links with Japanese companies. In reviewing the arrangement they have with their agents in Japan, they should keep in mind ‘the whole of chain approach’. They should question the role of the middleman in getting the product onto the shelves and consider the possibility and benefits of becoming more involved in the total process, particularly in the marketing of their products.

7.92 The Ricegrowers Co-operative is aware of the importance of securing a greater say in how their product progresses from the farm gate. In 1994, it formed a joint venture company, the Sunrice Inc, with a large Yokohama based rice miller, Mitsubashi Inc. The Sunrice company is licensed to import only Australian rice. It was formed to enable Ricegrowers Co-operative, through the Sunrice company, to capture more of the margins which accrue at each step in the Japanese supply chain. In explaining the reasons for establishing this company, Mr Milton Bazley stated that they were trying to:

...achieve greater tonnages through having our own company and potential lobbying within the Japanese system. Also, at each stage of the supply chain in Japan, there are huge margins to be made, and by us developing a company that is importing the rice and milling and is packaging the rice in Japan, it gives our shareholders the opportunity to share in those margins within Japan.⁹⁶

7.93 Over recent years, some innovative Australian exporters have availed themselves of the opportunities on offer in Japan and have managed to enter the Japanese market. Wine and cheese makers are good examples.⁹⁷

94 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 639.

95 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 632.

96 Milton Bazley, Ricegrowers Co-operative Ltd, *Committee Hansard*, 17 May 1999, p. 537.

97 Terence White, Australia-Japan Foundation, *Committee Hansard*, 19 February 1999, p. 46.

7.94 Schiavello is a Melbourne furniture company selling about 800 workstations to NTT, the domestic telecommunications carrier. Mr Dodds told the Committee:

Two or three years ago, selling anything to NTT was a nightmare because of the regulations surrounding it. Those were by and large designed to protect the interests of established Japanese suppliers.⁹⁸

7.95 Aside from the opportunity for Australian producers to become more involved in the sale and marketing of their product in Japan, investment potential is opening up for Australian companies.

Australian investment in Japan

7.96 Traditionally, Japan has not attracted significant overseas investment to its shores. In 1997, the Minister for International Trade and Industry, Mr Shinji Sato, observed that the ratio of foreign direct investment into Japan at the end of 1995 was only 7% of Japanese direct foreign investment overseas. He noted this unusually low level when compared to other major industrialised countries such as the 79% for the United States, 78% for France, 77% for the United Kingdom and 41% for Germany.⁹⁹

7.97 In 1998, the Commission of the European Communities noted that while Japan had a formal policy of encouraging foreign investment, high costs in Japan and over-regulation remained a major disincentive for foreign firms. It pointed out:

Factors deterring greater foreign investment in Japan include high business costs, high corporate taxation, difficulties in accessing distribution channels, the general regulatory environment and non-transparent business practices. The recent performance of the Japanese economy has further dampened foreign investment.¹⁰⁰

7.98 This situation is changing and historic difficulties of investing in Japan are disappearing. Austrade told the Committee that the level of foreign investment in Japan is still low but increasing.

7.99 JETRO believed that Japan is definitely becoming a friendlier place for overseas investment now that major problems, such as the effects of high domestic costs and recruitment of staff have been reduced significantly. It maintained that overheads in Japan continue to decline as deflation places downward pressure on prices, along with the flowthrough effects of deregulation. Recruitment too has changed, reflecting not only restructuring and lay-offs in Japanese companies but also the effects of social value changes as employees move away from Japan's lifetime employment ethos. Mr Hiroshi Nakano, Managing Director, JETRO, Sydney Inc,

98 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 636.

99 Shinji Sato, English Translation of Minister Sato's Speech at the Foreign Correspondents' Club of Japan, 16 June 1997, <http://www.miti.go.jp/press-e/f300001e.html> (24 April 2000).

100 Commission of the European Communities, *List of EU Deregulation Proposals for Japan*, 12 October 1998, p. 6.

advised that as the investment trend from the rest of the world is already clearly evident in Japan, Australian companies should not lag behind.¹⁰¹ JETRO has in place various programs to assist Australian businesses including the Export to Japan Program and the Region to Region program.

7.100 Austrade agreed that investing in Japan had become easier, particularly as reforms were beginning to remove major obstacles. It noted that deregulation, such as the relaxation of the foreign currency exchange laws, had given foreign investors who had entered areas, which had previously been dominated by Japanese companies, 'some early and unexpected windfalls'. It submitted:

Sophisticated foreign players have real opportunities to enter the market whether it be through know-how transfer or capital participation, as illustrated by the number of US and European firms that have moved into these sectors in just the past year.¹⁰²

7.101 The slowdown in the economy had also created attractive opportunities for overseas investors. To consolidate their hold over business activity in Japan, the large Japanese companies had, over many years, created a network of subsidiaries to deal with specialist areas of business. This structure is now starting to crumble. Austrade told the Committee that at the beginning of May 1999, the trading companies announced collectively that they were selling off over a thousand of these subsidiaries, a number of which managed the more technical niche market areas of trading companies business, such as software. According to Austrade, such developments offer significant investment opportunities for those wishing to establish a presence in the Japanese market. The Americans are taking this opportunity to invest in Japan.¹⁰³

7.102 Mergers and acquisitions offer particular opportunities for foreign investors. Japanese companies experiencing economic difficulties are now welcoming foreign assistance. JETRO explained that one cause for the growth in mergers and acquisitions was the need for Japanese firms to sell:

The recession since the second quarter of 1997 has hit Japanese firms profits, and they are now restructuring by selling off unprofitable businesses and strengthening their financial structures. This need to sell has coincided with foreign firms interest in buying, hence resulting in more M&As targeting Japanese firms. This is particularly so in the real estate and financial sectors.¹⁰⁴

101 Hiroshi Nakano, Japan External Trade Organisation, Sydney, Ltd, *Committee Hansard*, 3 September 1999, p. 789.

102 Austrade, submission no. 35, p. 9.

103 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, pp. 629–630.

104 JETRO White Paper on Foreign Direct Investment (1999), p. 60. See also Paper 'Prospects for the Japanese Economy', The Japan Research Institute Ltd, Economics Department, July 1999, p. 9.

7.103 Austrade pointed out that ‘Majority acquisitions, joint venture buy-outs—just establishing a minority interest is obviously a sensible first step for people’.¹⁰⁵ An example of a purchase of a significant minority interest was Renault’s 37% purchase of Nissan in 1999. In March 2000, DaimlerChrysler announced that it was taking effective control of Mitsubishi Motors through a 34% holding.¹⁰⁶

7.104 Undoubtedly, the investment environment in Japan is becoming more hospitable for overseas interests. Overall, most foreign firms are finding prejudice against them declining, recruitment problems lessening and legislative controls on business easing.¹⁰⁷

7.105 This friendlier commercial setting together with growing investment opportunities in Japan should encourage Australian business to consider investing there. Austrade was encouraging people at least to consider such investment and offering support to companies contemplating setting up business there. It thought that the message about the possibilities for Australian investment in Japan was starting to filter through to the business sector but needed to be more forcefully, frequently and directly delivered. Officers from Austrade recognised that they needed to drive home this message about opportunities to potential Australian investors and intended to hold meetings with major accountancy and business consultancy firms. Mr Dodds told the Committee:

Part of the message we are delivering here is that investment in Japan in many ways is attractive in its own terms and people should look at it in that way, but it is not really an option to sit back and think ‘...we’ll think about it next year. In the meantime, everything will remain the same’. It might not. There is a chance of losing as well as gaining here.¹⁰⁸

7.106 Austrade, however, noted that Japan is a significantly different investment proposition from many other countries:

The people who are available to invest in by and large are the people who are failures or semi-failures. There is something wrong for a start. Even in Japanese terms, they cannot succeed or stay above water. If they are going to become a good investment proposition, they have to be given a new product and a new way of doing things and led to success...you have to bring something more than money to the table.¹⁰⁹

7.107 Many witnesses reinforced the view that Japan offered great potential for business; that despite the recession in Japan, opportunities were opening up for

105 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 638.

106 *AsiaNow*, 5 November 1999, vol. 25, no. 44.

107 JETRO, *JETRO White Paper on Foreign Direct Investment 2000*, p. 63.

108 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 639.

109 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 639.

Australian exporters and it was time for Australian business to capitalise on them.¹¹⁰ Both Mr Pokarier and Mr Dodds, however, added a cautionary note, reminding Australian producers that even with regulatory reform, there is 'no guaranteed pay-off for foreign firms in the Japanese market'. Mr Pokarier stressed that new comers to the Japanese market must start with a recognition that most sectors are characterised by intense domestic competition. There are hundreds of publicly listed companies in Japan that are world market leaders in their product line including Sony, Mitsui, Nintendo and Sega. These firms are world class and have grown out of intense domestic competition.¹¹¹

7.108 A number of academics at the Australia-Japan Research Centre are also very enthusiastic for Australian investors to become involved in the Japanese market. They identified specific areas such as distribution, processed foods, finance, telecommunications and computer software applications, where changes are occurring rapidly and where Australia has proven expertise and noted success. They stated:

In these sectors, where openings are greater than elsewhere and where other foreign players are acting, it is particularly important that Australian firms reassess the current opportunities for them in Japan and the competitive threats from rival firms who are prepared to invest in the Japanese market.¹¹²

7.109 They, too, issued a word of caution. Despite opportunities in the current circumstances, they urged companies to 'spend time and effort to understand and establish themselves in the Japanese market before undertaking substantial investments there'.¹¹³

7.110 In summary, Japanese consumers are demanding wider choices and better services, traditional business relationships are opening up, regulations are being dismantled or revised, new players are nuzzling in on the previously closed distribution system, and increased foreign involvement is now accepted as inevitable. Moreover, there are Japanese businesses looking to be rescued from their financial difficulties. The Committee believes that it is time for Australian firms to consider establishing a presence in Japan. Continuing reform presents opportunities but Australian producers must be alert, well-informed and motivated.

110 Professor David Allen, *Committee Hansard*, 25 February 1999, p. 181; Dr Craig Freedman, *Committee Hansard*, 15 April 1999, pp. 345–6; Perce Butterworth, New South Wales Department of State and Regional Development, *Committee Hansard*, pp. 394–95.

111 Christopher Pokarier, *Committee Hansard*, 16 April 1999, pp. 423, 432.

112 Peter Drysdale, Toshi Naito, Ray Trewin and Dominic Wilson, 'The Changing Climate for Foreign Direct Investment into Japan', *Pacific Economic Papers*, no. 293, Australia-Japan Research Centre, July 1999, p. 37.

113 Peter Drysdale, Toshi Naito, Ray Trewin and Dominic Wilson, 'The Changing Climate for Foreign Direct Investment into Japan', *Pacific Economic Paper*, no. 293, Australia-Japan Research Centre, July 1999, p. 39.

Value-adding in Australia

7.111 During the course of the inquiry, the issue of value adding to goods in Australia destined for export was raised. Traditionally, Australian exports that have originated in the rural sector have been unprocessed or only lightly processed commodities. These include wheat, raw sugar, skim milk powder and wool. According to Mr Paul Reithmuller:

Most of the value adding activity has occurred in the wool mills of Korea, the flourmills of China and the dairy factories of Indonesia. The prices of bulk commodities have been trading downwards for years and this has been perhaps the main factor behind the move to do more value adding in Australia. The grape industry has probably been the most successful judging by what it has achieved on export markets with wine.¹¹⁴

Cheese is another value-added product that is selling well in Japan.¹¹⁵

7.112 But as noted earlier, unprocessed commodities such as coal, iron ore and grains dominate Australia's exports to Japan. The structure of Japan's overall imports, however, is changing as Japan continues to open its markets and to purchase more value added goods and services. Importantly though, Japan's imports from Australia remain predominantly resources and not consumer goods.

7.113 In other words, while Japan is importing more value-added goods and services, Australia has not shared in this expanding market. This situation also runs contrary to the overall trend in Australia's export trade. In brief, Australia has been increasing its exports of value-added goods and services but not to Japan.¹¹⁶ Mr Panagiotopoulos made the following point:

In 1993 11.5% of Australia's exports to Japan were manufactures (excl Foodstuff) and in 1997 this figure was 13.5%. In 1993, 97.7% of imports from Japan were manufactures (excl Foodstuff) and in 1997 this figure was 97.9%.¹¹⁷

7.114 The Committee noted in the last chapter that the export of manufactures to Japan had peaked in 1988 at 17.7% of total Australian exports to Japan, which fell to

114 Paul Riethmuller, 'Major Trends Affecting Australia's Agricultural Industries: Have they Taken a Turn for the Worse?', *Economic Issues No. 3*, November 1998, p. 14.

115 Paul Riethmuller, 'Major Trends Affecting Australia's Agricultural Industries: Have They Taken a Turn for the Worse?', *Economic Issues No. 3*, November 1998, p. 14; and Terence White, Australia-Japan Foundation, *Committee Hansard*, 19 February 1999, p. 46.

116 Manuel Panagiotopoulos, *Committee Hansard*, 14 April 1999, pp. 215, 219.

117 Manuel Panagiotopoulos, *Japanese and Australian Trade 1988-1997*, Manuel Panagiotopoulos, AJEI Communications, Sydney, p. 19.

14.7% in 1990.¹¹⁸ This pattern of trade where Australia is lagging behind selling value added goods to Japan warrants careful study.

7.115 Witnesses were keen for Australia to do more value-adding to products before exporting. Mr Owen Clare, adviser with Saw James Capel told the Committee that Australians 'have for too long focused on digging it out and selling it, and not adding any value, and we are now paying the price for that, because we are the victim of whatever price these importing countries are prepared to pay for the exports that we want to sell them'.¹¹⁹ Mr Ken Court observed that the iron ore industry stands out as a complete misfire in this area of downstreaming.¹²⁰ He advocated the development of a very large gas-fired steel industry in Australia based on new technology that would have environmental concerns as its strongest selling point. He told the Committee:

...firstly, we have the gas supply and, secondly, we have got the technology now for large scale electric arc furnace production, no longer mini-mills, and it has changed.¹²¹

7.116 Mr Court suggested that the Federal Government should be joining the State Governments in putting infrastructure in place to facilitate downstreaming. The Department of Industry, Science and Resources, in responding to suggestions about companies embarking on value-adding operations, maintained that such decisions were 'a judgment call that individual companies will have to make in terms of trying to attract investment'. It explained that the Australian Government was involved through programs such as, Invest Australia, which is working to attract investment into the downstream processing sector. While acknowledging that at the end of the day the decision to value-add is a commercial one, the Department agreed that the Australian Government 'could be looking at any areas from which blockages to that sort of activity could be removed'.¹²²

7.117 JETRO is actively promoting the export of value added goods to Japan. It, nonetheless, agreed that the decision to value add is a fundamental question of economics. Put succinctly: 'You need to be competitive.'¹²³ Applying this general principle to the iron ore industry, Dr Freedman questioned the economic wisdom of developing more steel producing plants in Australia. He observed:

118 See chapter 5, para 5.55.

119 Owen Clare, Senior Equities Adviser, Saw James Capel Ltd, *Committee Hansard*, 24 February 1999, p. 150.

120 Kenneth Court, *Committee Hansard*, 24 February 1999, p. 144.

121 Kenneth Court, *Committee Hansard*, 24 February 1999, pp. 138, 140.

122 Craig Burns, Department of Industry, Science and Resources, *Committee Hansard*, 28 May 1999, p. 693.

123 Hiroshi Nakano, Japan External Trade Organisation, Sydney Inc, *Committee Hansard*, 3 September 1999, p. 795. See also comments by Manuel Panagiotopoulos who acknowledged that value adding to Australian commodities in Australia was not happening because 'it is not economically viable for corporations to do that here'. He suggested Australians need to ask the right questions to find out why this is not the case, *Committee Hansard*, 14 April 1999, p. 220.

Looking at the world market, the last thing it needs is steel. The Japanese are cutting back. Are we going to be as efficient as the Pohung works in South Korea? No. Is our comparative advantage in steel making? No I think not. I think we would be barrelling into a declining world manufacturing area; we would be coming in there 40 years at least too late.¹²⁴

7.118 In assessing the feasibility of value adding to iron ore in Western Australia, the Western Australian Treasury argued that there are two sets of conditions:

...competitive cost structures domestically—so in that sense the gas pipelines; deregulation of the gas market has been quite profound in setting up the right conditions—and reforms to the labour market, introducing flexibility. In that sense our domestic conditions are now quite well placed to enter into full-scale downstream processing.

7.119 However, the Western Australian Treasury returned to the basic issue of economics—‘you require strong markets, the timing has to be right’.¹²⁵

7.120 There are clear advantages to value adding or downstreaming. It allows the economy a greater capacity to capitalise on its resources and it means more jobs and greater profits. Austrade used the tuna industry to illustrate the benefits that accrue with value adding in Australia:

Take the marine products: rather than just sending tuna off to the market, frozen into things like logs, the tuna has to be cut up and processed here and then sent off to the supermarket in the form it can use on its shelves. If the Australian company is on its toes, it can start talking about doing the packaging in Australia so the product goes off to Japan in a state that can more or less be put straight onto a Japanese supermarket shelf. This employs a lot more people here.¹²⁶

7.121 There are also risks associated with value adding. The Western Australian Treasury pointed out that one of the main trade-offs with downstreaming is narrowing the market for the product.¹²⁷ Overall, Dr Sheales, Manager, Agriculture and Food Economics Branch, ABARE, submitted:

The reason that we are predominantly an exporter of raw materials is that that is what we do best. We have a very clear comparative advantage and that has therefore been reflected in the way our industries have developed. It is not to say that there are not various forms of processing already taking place in this country. The aluminium industry would be a good one where a

124 Dr Craig Freedman, *Committee Hansard*, 15 April 1999, p. 354.

125 Timothy Marney, Treasury Department of Western Australia, *Committee Hansard*, 25 February 1999, p. 166.

126 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 634.

127 Timothy Marney, Treasury Department of Western Australia, *Committee Hansard*, 25 February 1999, p. 166.

fair bit of the alumina we produce is actually turned into metal because we have cheap electricity which is the key other input.

...It really depends on companies making their own commercial decisions within the environment they operate in. To varying degrees they will add value within the country, but for other reasons it is not worthwhile for them to do that.¹²⁸

7.122 Although the decision to value add is a commercial one, Australian exporters to Japan should be fully aware and alert to the gains to be won from value adding to their product. Austrade pointed out that producers need help to identify the opportunities. Mr Dodds told the Committee, 'if they have been going through a trading company they usually do not know where their product goes in the end—and the trading company is singularly unobliging in giving them that information'.¹²⁹

Making Australian products more competitive—infrastructure development

7.123 The decision to value add hinges on comparative advantage as does any commercial decision by Australian producers considering exporting. Japan is a highly competitive market and Japanese consumers set very high standards for the quality of the goods and services they purchase. Domestic policies can help Australian exporters improve their competitiveness.

7.124 The Western Australian Treasury suggested that Australia should consider policies that will foster a domestic environment that will place Australian exporters in a better position. It wanted to highlight the need:

... to ensure Western Australia and Australia's competitiveness is continually enhanced through the provision of appropriate infrastructure as efficiently as possible, through flexible labour markets which enable us, on the one hand, to be competitive and, on the other hand, to be reliable, and through general micro reform to ensure the economy continues to be as competitive as it can be on the international stage.¹³⁰

7.125 Mr Robert Cameron, Chairman, Australian Coal Association, drew attention to a number of changes that have brought direct benefits to Australian exporters, including reform to Australia's industrial relations law and to Australia's national competition policies; the creation of complete electricity markets which have lowered prices for major industrial users; and rail freight reductions achieved in NSW and Queensland. Although he argued that reforms are far from complete especially in regard to rail reforms, he stated:

128 Dr Terence Sheales, *Committee Hansard*, 21 June 1999, p. 741.

129 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, pp. 634–5.

130 Timothy Marney, Treasury Department of Western Australia, *Committee Hansard*, 25 February 1999, pp. 161–2.

The changes...have certainly enabled Australian producers to be more efficient and so better equipped to respond to an increasingly competitive and uncertain market.¹³¹

7.126 This matter of government involvement in fostering a domestic environment that will assist exporters improve their international competitiveness through various means, including infrastructure development, tax policies and labour market reforms is beyond the scope of this inquiry. Nonetheless, the Committee stresses the importance of the need for government, business and the broader community to work together to find ways to nurture a domestic environment that will minimise the costs of production, better use its human resources and improve efficiency for Australian industry.

Research

7.127 One area that holds promise for growth and where Australia may have a comparative advantage is in basic research such as medical research, various scientific research in the field of basic engineering and materials usage. Dr Freedman argued that in these areas Australia has people at the forefront of research—‘that is where Australia can have a leg-up on everyone else’.¹³²

7.128 Reinforcing this view, Mr Peter Hartcher drew attention to Australia’s large pool of ‘creative and technologically savvy people’. He argued that, because Australia lacks a substantial capital base, Australian researchers are without solid commercial backing to exploit fully their skills. In turning from Australia’s strength in this area of R&D, to Japanese vast excess capital, he noted the great opportunity for a productive association between Australian skills and Japanese capital:

...if the hallmark of the last half-century of economic relations between Australia and Japan has been the complementarity between Australian resources and Japanese manufacturing, the potential new complementarity could be complementarity between the Japanese economy that knows it needs to pursue more creativity and more technological fleet-footedness and Australia who can supply that.¹³³

7.129 According to Mr Hartcher, when the Japanese want technological innovation and ideas, they look to the United States. Similarly, when Australian venture companies seek development capital to build on their ideas they also turn to the United States. He saw an opportunity for:

Australia and Japan to exploit the complementarity there by trying to exploit Australia’s potential and Japan’s capital and needs by doing it directly rather

131 Robert Cameron ‘The Australian Coal Industry—Meeting the Challenges’, Fifth APEC Coal Flow Seminar, Yokohama, Japan, 4 February 1999.

132 Dr Craig Freedman, *Committee Hansard*, 15 April 1999, p. 352.

133 Peter Hartcher, *Committee Hansard*, 15 April 1999, pp. 327.

than going to the larger marketplace of the US, where it is a pretty crowded marketplace already.¹³⁴

7.130 He suggested that anything that can be done to bring the private and academic sectors on each side together more often should be pursued with enthusiasm.¹³⁵

7.131 The Committee found that this area of Australian R&D is one that warrants close and serious consideration and certainly should be accorded a higher priority by the Australian Government. The Committee believes that the potential for a more productive partnership in science and technology between Australia and Japan is unrealised. It agrees with witnesses who can see a beneficial marriage between Australian technology and Japanese capital and urges the Australian Government to explore ways to bring together the talent of Australian researchers with the enterprise and backing of Japanese business people.

Regions—think beyond Tokyo

7.132 A number of witnesses urged Australian exporters to look beyond the boundaries of the major Japanese cities, especially Tokyo. They suggested that rather than concentrate on the capital city, export promotion should be deployed on a country-wide basis. Mr Pokarier argued strongly that by targeting the regions in Japan Australian producers could find a range of market opportunities not found in Tokyo.¹³⁶

7.133 JETRO shared this view and stressed the importance of a regional approach to Japan, because ‘not only Tokyo but other areas of Japan are very eager to have foreign companies in their own area’.¹³⁷ Austrade also encouraged Australian companies to consider establishing a presence in a regional area. It noted that areas other than Tokyo are economies in their own right, such as Kansai, the area around Osaka, which is larger than Canada; and Kyushu, the island in the west of Japan which is bigger than the Korean economy. Mr Greg Dodds told the Committee:

The Japanese retail sector is characterised by a couple of very large players like Daiei and Jusco and then hundreds of small to medium sized operators, particularly in the regional level. It would definitely be a strategic option for an Australian retailer. If we were approached, we would suggest they look at buying one of them at a regional level, learn how to make it work in an area like Kyushu or Sendai, where we have an office and could support the process, and then to go national from there.¹³⁸

134 Peter Hartcher, *Committee Hansard*, 15 April 1999, p. 328.

135 Peter Hartcher, *Committee Hansard*, 15 April 1999, p. 329.

136 Christopher Pokarier, *Committee Hansard*, 16 April 1999, p. 437.

137 Hiroshi Nakano, Japan External Trade Organisation, Sydney Inc, *Committee Hansard*, 3 September 1999, p. 798.

138 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, pp. 636, 642.

Austrade offices in North-east Asia



7.134 The experiences of Australian building firms operating in the regional areas bears out this advice. Mr Ian McLean, whose firm has been working in Matsuyama on the Island of Shikoku, which has a population of over a million, knew of the opportunities for Australian businesses. In essence, he stated 'it is so much easier because they want to do business'.¹³⁹ To promote this regional approach, Austrade has expanded its regional representation in Japan. There are now Austrade officials or consuls in Osaka, Sendai, Fukuoka, Nagoya and Sapporo.¹⁴⁰

139 Ian McLean, Australia Japan Housing Ltd, *Committee Hansard*, 15 April 1999, p. 365.

140 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 635.

7.135 A number of cities in Australia have established a sister city relationship with a city in Japan. Although the intention is to promote mutual friendship by developing and strengthening social and cultural interaction between individuals and groups in the two cities, there is great scope for the development of commercial ties that would benefit both communities. The City of Whitehorse Council, the Hastings Council and the Lismore City Council, who have well established sister city relationship with a city in Japan, clearly value their association but are keen to build on their relationship to foster economic and business contacts with their respective sister city.¹⁴¹ The Committee believes that this is an area that provides potential not yet fully realised for Australian business to link up with regional Japan.

7.136 The Committee acknowledges the importance of keeping Australian business informed about the opportunities waiting to be taken up in the regional areas of Japan and of encouraging and assisting Australian business to take advantage of any such opportunities.

Recommendation

The Committee recommends that the Department of Foreign Affairs consult with representatives from cities involved in a sister city relationship to develop strategies that will help them forge better trade ties with their respective sister city in Japan.

Japan's foreign investment in Australia

7.137 The Committee has shown that the decision by Australian exporters and investors to break into the Japanese market depends significantly on their perception of that market. Many in Australia shun the opportunities on offer in Japan because they still regard Japan as a difficult place to do business. The same principle may apply to Japanese considering the potential of the Australian market. Their understanding of Australia might well inhibit their commercial involvement in Australia.

7.138 As a capital poor country that welcomes injection of foreign funds, Australia has a long tradition as a reliable, stable and friendly trading partner. In Professor Rix's opinion, the Japanese would probably prefer to deal with Australian companies more than almost anybody else. Although it is not a formal relationship in the sense of an alliance, the Australia-Japan association has proven to be very beneficial to both countries.¹⁴² Australia's standing as a valuable partner holds it in good stead in the Japanese market place but it does not guarantee continued or expanding investment by Japan in Australia.

141 See Whitehorse City Council, submission no. 2, p. 1; Hastings Council, submission no. 4, pp. 1-2; Lismore City Council, submission no. 11, p. 2.

142 Professor Alan Rix, *Committee Hansard*, 16 April 1999, p. 449.

7.139 Australia must alert the Japanese to the opportunities in Australia for investment. The main aims of Japanese overseas investment since the war have been to secure sources of raw materials and foodstuffs and to improve market prospects for Japanese manufacturing industries. It was the forward contracts offered by Japanese industry that lay the foundations for financing the large-scale mineral projects which unlocked Australia's extensive mineral wealth.

7.140 Since the mid-1980s Japan has invested in a range of industries that has varied according to the changing nature of the Japanese economy. According to Professor Drysdale and Mr Roger Farrell:

While the need to secure supplies of raw materials and energy was a key motivation for Japanese FDI in resource development in Australia, the relatively small domestic market discouraged manufacturing FDI unless import barriers provided an incentive to establish local operations. A considerable part of FDI has been associated with establishing wholesale and retail networks to facilitate bilateral trade and provide a distribution network for locally established Japanese firms.¹⁴³

7.141 Even so, foreign investment has always been a contentious issue for debate in Australia. It has been only a little over ten years since the purchases of real estate by Japanese companies ignited controversy and generated anti-Japanese sentiments in Australia.¹⁴⁴ The Australian economy, however, has benefited substantially from Japanese investment and is well placed to remain a major beneficiary of continued direct investment.¹⁴⁵ Nonetheless, there are many other countries seeking to attract investment from Japan and Australia will have to compete against this wide range of other investment destinations. Austrade told the Committee:

For quite a long time, when we tried to encourage Japanese direct investment in Australia, many Tokyo companies have come back to us with the cost of labour, the cost of land, and these negatives about Australia—not so much the negatives about Australia but the positives of an Asian

143 Peter Drysdale and Robert Farrell, 'Perspectives on Japanese Investment, Employment and Management in Australia', *Pacific Economic Papers no. 290*, Australia-Japan Research Centre, April 1999, pp. 42–3. FDI is the acronym for foreign direct investment.

144 Yukio Satoh, 'From Distant Countries to Partners: The Japan-Australia Relationship', *Working Paper no. 312*, November 1997, Strategic and Defence Studies Centre, 1997, p. 3. See also Purnendra Jain and Donna Weeks, 'Banking on the "Constructive Partnership"', *Current Affairs Bulletin*, vol. 69, No. 9, February 1993, pp. 14–16.

145 For example see Austrade, submission no. 35, pp. 7–8, 16. See also, Peter Drysdale and Robert Farrell, 'Perspectives on Japanese Investment, Employment and Management in Australia', *Pacific Economic Papers no. 290*, Australia-Japan Research Centre, April 1999, pp. 42–3; Manuel Panagiotopoulos told the Committee that 'A large proportion of investment in real estate has since left due to the financial troubles of the parent companies in Japan. However, Japanese investment in Australia is well established and will remain for the long term', *Committee Hansard*, 14 April 1999, p. 215.

destination like Malaysia or Indonesia compared with Australia; that these things were cheaper.¹⁴⁶

7.142 Japanese investment is an area where Australia must create its own opportunities by actively encouraging Japanese interest. The potential to marry Australian research skills with Japanese capital has been noted. But, Australia's business profile in Japan is small in comparison to the size of the trade relationship. JETRO suggested that Australian government and business should have a bigger presence in Japan. This would have two advantages—'it would create an awareness among Japanese about Australia and it would expose Australian business to direct market experience in Japan.'¹⁴⁷

7.143 Even more so, some impressions about Australia's labour productivity including Australia's 'notorious strike record', may still linger, despite improvements over recent years, and undermine Australia's efforts to attract Japanese investment.¹⁴⁸ Mr Manuel Panagiotopolous noted that there are examples of executives in Japan who are basically uninformed. He suggested that 'Their understanding of our country may still be of the Australia of 15, 20 years ago'.¹⁴⁹ According to Mr Seiji Kawarabayashi, Chairman of the Federation of Japan Chambers of Commerce and Industry in Australia:

The perception in Japan...is that Australia is a small, mature market with limited growth potential, mainly in the areas of resources, energy and leisure. It is up to Australia to firmly focus on the future, reinvent itself to compete globally, and benefit from the growth in Asia.¹⁵⁰

7.144 In underlining this point, the Committee for Economic Development of Australia submitted:

...the future must also be our own creation...It is not simply a matter, however, of being good: we must also be known to be good. Impressions count for a great deal.¹⁵¹

The Australia Japan Foundation agreed and urged Australia to do more to engage Japanese attention. It told the Committee:

146 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 641.

147 Hiroshi Nakano, Japan External Trade Organisation, *Committee Hansard*, 3 September 1999, p. 797.

148 See Peter Drysdale and Robert Farrell, 'Perspectives on Japanese Investment, Employment and Management in Australia', *Pacific Economic Papers no. 290*, Australia-Japan Research Centre, April 1999, p. 2.

149 Manuel Panagiotopoulos, *Committee Hansard*, 14 April 1999, p. 223.

150 Quote taken from CEDA, *Japanese Trading Companies: Their Role in Australia's Economic Development*, a study undertaken by INSTATE Pty Ltd, Sydney, 1997, p. 70.

151 CEDA, *Japanese Trading Companies: Their Role in Australia's Economic Development*, a study undertaken by INSTATE Pty Ltd, Sydney, 1997, p. 69. See also comments by Owen Clare, Senior Equities Advisor, Saw James Capel Ltd, *Committee Hansard*, 24 February 1999, p. 156.

...we have to be talking differently about ourselves in the future. We can no longer be kangaroos, koalas and beaches; we can no longer be simply coal, iron ore and primary products. We have to be selling Australian know-how; we have to be selling Australian sophistication; we have to be sending messages to the average citizen in Japan that Australia is equally a target for their interest with the United States, with Europe and with South-East Asia.¹⁵²

7.145 The Australian Government and Australian business need to have a clear understanding of how Australia is perceived overseas and to decide how this perception can be improved. Australia must project a strong positive image as a ‘can do’ nation, able to supply sophisticated goods and services.

7.146 Moreover, within Australia there is a need to promote public awareness and develop a sense of balance in appreciating the benefits of Japanese direct investment. A sound understanding of the nature, extent and benefits deriving from such investment would give a more accurate perspective to the debate and would certainly send a far more encouraging message to potential Japanese investors.¹⁵³

7.147 The Committee accepts Australia cannot take Japanese investment for granted; that Australia must take the initiative and work hard to present itself to the international business world as an attractive investment proposition. The Australian Government clearly has a crucial role in promoting a strong image of Australia as a nation that will reward its investors.

Japan’s understanding of Australia

7.148 The need for understanding and appreciation should flow both ways if the relationship between Australia and Japan is to grow in a balanced and mutually beneficial way. The Japanese people generally have a positive image of Australia. A survey by the Nippon Research Centre showed that Australia continues to rate as one of the most popular and trustworthy countries by the Japanese.¹⁵⁴ The Committee in the course of its inquiry heard evidence that Australia, on the whole, is recognised as a safe, clean and green country, that enjoys stable government and produces mainly primary products such as coal, iron ore, wool, wheat and beef. This reputation while conveying a most favourable impression can be restrictive.

7.149 Although Australia has a good name, the image is often ‘indistinct and dated’. Clearly the predictable and cliched stories of Australia in Japan of beaches, koalas and

152 Terence White, Australia-Japan Foundation, *Committee Hansard*, 19 February 1999, p. 38.

153 See Purnendra Jain and Donna Weeks, ‘Banking on the “Constructive Partnership”’, *Current Affairs Bulletin*, vol. 69, no. 9, February 1993, pp. 14–16 for views on this matter of Japanese investment.

154 NSW Government, submission no. 25, p. 4.

kangaroos and lazy workers who lounge around all day long are misleading.¹⁵⁵ According to DFAT Australia is seen as:

...a collage of a country rich in agriculture and minerals and blessed with sun, surf and space. There is only a limited understanding of Australia's technical capabilities, of its record of innovation and achievement in science and industry or of the extent of Australia's cultural diversity. Unless others know us better, and we others, our relationship will remain limited and the capacity to pursue Australia's national interests diminished.¹⁵⁶

7.150 Research particularly in relation to tourism supports DFAT's assessment of how Australia is perceived overseas. It shows quite clearly that Australia is portrayed typically as a land of surf and sun. The tourist industry recognises the limitations that such a shallow representation can have on attracting Japanese visitors to Australia. But this narrow depiction of Australia spills over into other areas of exchange. Our universities suffer in not being able to attract top Japanese students, Japanese investment in Australia may remain in traditional areas such as minerals, beef, tourism infrastructure and automobiles because Japanese lack an appreciation of Australia's full potential.

7.151 Moreover, as pointed out by QSC, Australia has particular interests that Japan as a major trading partner should be aware of and understand. Our push for the liberalisation of agricultural products is one such matter.

7.152 Perception is a powerful force in shaping relationships and it is important that Australia ensure that its potential is fully understood and appreciated by Japan. The Committee has shown that a range of industries are working very hard to convey positive impressions of their particular product or sector. The coal industry has an established reputation as a reliable supplier and is working toward creating a more environmentally friendly image. Iron ore and LNG producers and rice and wheat growers are consolidating their name as reliable suppliers. LNG is also marketing its product as safe and clean, and the Australian rice, wheat and beef industries are acknowledged as producers of a high quality product. The tourist industry is striving to broaden its image and the education industry has work to do to build a stronger profile in Japan.

7.153 The Committee found that despite the individual efforts of different sectors in the Australian community to promote their particular product, the extent and range of Australia's potential is undersold in the overall understanding of Australia. Mr White of the Australia Japan Foundation believed that it is the responsibility of all who are associated with Japan to work to enhance Australia's image overseas. But he noted that the Australian Government must coordinate these efforts; it must have 'a political

155 For example see David Askew, *Committee Hansard*, 17 May 1999, p. 552.

156 Commonwealth of Australia, *In the National Interest: Australia's Foreign and Trade Policy White Paper*, 1997, p. 78.

will' to bring together all the elements in the community to effectively promote Australia.¹⁵⁷

Recommendation

The Committee recommends that the Department of Foreign Affairs and Trade analyse and evaluate the existing means it uses to promote Australia's image internationally with a view to implementing measures that will raise Australia's profile overseas and convey more effectively an image of Australia that reflects its strengths and potential.

157 Terence White, Australia-Japan Foundation, *Committee Hansard*, 19 February 1999, p. 51. See also views of Philip Henry, Department of State Development, Queensland, *Committee Hansard*, 16 April 1999, p. 410.

EAST ASIAN HEMISPHERE



CHAPTER 8

JAPAN'S RELATIONS WITH ITS LEADING TRADING PARTNERS

Japan's place in Asia

8.1 To this point, the Committee has concentrated on developments in Japan and their implications for Australia. The Australia-Japan trading relationship, however, is not conducted in isolation; it is very much part of a wider regional and global economic network. The management of future Australia-Japan relations must take account of developments in this network and, in particular, the tenor of its relations with other countries. In this chapter, the Committee looks at Japan's role in the Asia Pacific region, its relationship with its largest trading partner the United States and the emergence of China as an economic power.

8.2 Japan is the second largest economy in the world. It occupies an even more dominant place in the Asian region, where its economy is by far the largest. With 70% of Asia's GDP, Japan is 'twice as large as all the rest of the Asian economies put together, and is seven times the size of the Chinese economy'.¹ It has a pivotal role in regional trade and investment flows and is deeply involved in Asian economies in terms of trade, investment and financial transactions. Japan's position at the centre of a network of investments and aid programs throughout Asia strengthens the economic integration of Japan in the region.² Overall, the sophistication and sheer size of Japan's economy will guarantee its place as the leading economic power in Asia for many years to come.³

8.3 Asia's share of the world's GDP in 1965 was a modest 9 per cent but since that time, and most notably during the early 1990s, Asia's economy has blossomed. In 1995, Asia's share of world GDP passed the 25 per cent mark.⁴ During this period of economic growth, a close interdependence between Japan and other Asian economies developed. From the late 1980s, Japanese companies took an increasing interest in direct investment in Asian economies and Japanese-affiliated companies in Asia have played a substantial part in expanding trade in the region. In particular, the Japanese manufacturing industry has built an extensive production network in East Asia.

1 Figures taken from Speech given by Consul-General Shimanouchi, March 1999, 'Economic Crisis in Asia and What Japan is Doing', <http://www.embjapan.org/miami/speech4.html> (3 April 2000)

2 DFAT, submission no. 32, p. 7; Austrade, submission no. 35, p. 5.

3 DFAT, submission no. 32, p. 5.

4 Hisamitsu Arai, Vice-Minister for International Affairs, MITI, 'A Scenario for Dynamic Recovery from the Asian Economic Crisis', 21 August 1998, <http://www.miti.go.jp/report-e/g311002e.html> (19 November 1998).

8.4 The late 1980s witnessed a period of intense foreign investment when firms from Japan were looking for lower cost production bases abroad to escape escalating costs at home and the appreciating yen. This surge in manufacturing in Asia caused an ‘unprecedented shift in productive capacity within the region’.⁵

8.5 Mr Hisamitsu Arai, Vice-Minister for International Affairs, MITI, explained in August 1998, the evolution of this close interdependent relationship between Japan and Asian economies:

The roots of our interdependence lie in the Asian growth mechanism. In the late 80s, Japanese companies began to establish offshore operations and Japanese import[s] substantially increased subsequently, providing [a] new market for Asian economies.

The first countries to grow were the Newly Industrializing Economies, consisting of the Republic of Korea, Taiwan, Hong Kong, and Singapore. When the NIEs eventually found their own currencies rising, they responded in much the same way as Japan had during the period of yen appreciation. They began to shift to domestic, demand-led growth, and to increase their imports from ASEAN and China, developing production bases in these expanding economies.

As ASEAN nations and China began to grow at unprecedented rates, Japan and the NIEs continued to increase their consumption of imports and their industries continued to move offshore.

As a result, Asia now has an extremely high degree of intraregional trade interdependence. This intraregional structure is also apparent in terms of investment. The NIEs have been the major investors in ASEAN and China, followed by Japan. Trade interdependence within the region—including Japan and the nine East Asian countries—namely, the four NIEs, four major ASEAN economies and China—has risen as high as 52 per cent.⁶

8.6 In the process of developing closer economic ties with Asian economies, Japan’s aid program has often worked hand in glove with private sector interests. In 1992, Mr Edward J. Lincoln observed that Japanese bilateral foreign aid remained closely coordinated with, and connected to, other Japanese commercial interests. There was an understanding that foreign aid projects should be used to provide the infrastructure needed by Japanese firms investing overseas. He noted:

5 Stephen Thomsen, ‘Southeast Asia: the Role of Foreign Direct Investment Policies in Development’, Working Papers on International Investment, 1999/1, OECD, 1999, pp. 4–5, 12.

6 Hisamitsu Arai, Vice-Minister for International Affairs, MITI, ‘A Scenario for Dynamic Recovery from the Asian Economic Crisis’, Thailand-Japanese Association and JETRO, Bangkok, 21 August 1998.

A major increase in direct investment, supported by large amounts of foreign aid helping to create the necessary infrastructure for that investment, is the principal vehicle for the increasing Japanese investment in Asia.⁷

8.7 Japan has continued to invest heavily in the region and is now a major generator of foreign direct investment. According to the *OECD Observer*:

Japan is now the largest single investor in terms of stock in Thailand, Indonesia and Malaysia, and the second largest in the Philippines after the United States. And while Japan has helped to expand Asia's productive capacity in the last few decades, it has also played a key role in boosting the inflow of technology, know-how and human resource development in the region.⁸

The Asian economic crisis

8.8 The emergence of this web of close commercial ties that link Japan with other Asian economies means that any significant disruption in one economic system will register in the other.

8.9 During the first half of the 1990s, East Asia had been the growth centre of the world and its economies were achieving outstanding success. This economic boom came to a jarring halt in 1997 with the onset of the Asian economic crisis. It began in Thailand in July 1997 heralded by a plunge in the value of the Thai baht, and spread rapidly throughout Asia.

8.10 Given the sheer dominance of the Japanese economy in the Asian region and the close economic interdependence that has developed between Japan and Asia, Japan has a substantial capacity to influence regional affairs. Although Japan's economy had been sluggish since its bubble economy collapsed in 1990, its poor performance did not trigger the Asian economic crisis. The genesis of the crisis lay elsewhere. It is true, however, that once the economic crisis gathered momentum, Japan's ability to make a significant contribution to the recovery was constrained by its own ailing economy. JETRO argued:

East Asian countries had been highly dependent on exports to Japan, and Japan's imports from the region are more responsive to Japan's economic growth than to price fluctuations. East Asian economic recovery is therefore intimately tied to economic recovery in Japan, which, it is hoped, will be speedy and lead to ongoing growth.⁹

7 Edward J. Lincoln, 'Japan's Rapidly Emerging Strategy Toward Asia', Technical Paper No. 58, Research Programme on Globalisation and Regionalisation, OECD, April 1992, pp. 9, 27–8.

8 'Japan and Asia: developing ties', *OECD Observer*, 1 August 1999.

9 JETRO, *JETRO White Paper on International Trade, 1999*, p. 26. See also evidence presented by Colin Haseltine, DFAT, *Committee Hansard*, 15 February 1999, pp. 23–4.

8.11 If the Japanese economy remains in recession or very near to negative growth rates, its ability to assist the Asian economies regain their economic dynamism is severely curtailed. In other words, a shrinking Japanese economy means a limited role for Japan 'in salvaging Asian partners from the serious recession in the wake of the financial crisis'.¹⁰

Japan's own recovery a tonic for the region.

8.12 Some countries, however, are concerned that Japan will try to export its way out of trouble instead of looking to lift economic activity through domestic-led growth. Rather than expand its export market, Japan has been called on to revive its own economy so that it will create increased demand for imports. A number of economists pointed out:

While a depreciation of the yen may be a necessary component of Japanese adjustment, it is critical that Japan not rely predominantly on external demand to extricate itself from recession. Such a development in Japan would significantly impair the ability of the poorer, more deeply affected, Asian countries to recover from the crisis.¹¹

8.13 Professor Drysdale agreed. He argued that Japan's recovery would help economies across East Asia rebound, reinforcing what is going on in the rest of East Asia and encouraging domestic recovery even further.¹² Put in its simplest terms, Professor Haruo Shimada stated:

The single most important role that Japan can play to help Asian economies to recover from the damage of financial and economic crisis is to grow and to purchase commodities produced in the hard hit Asian economies. The vigorous growth of [the] Japanese economy can help recovery of Asian partners by promoting their exports to [the] Japanese market at better prices.¹³

8.14 In general, the Japanese Government accepts willingly that it has an obligation to help its neighbours—that it must do more to revive its economy if it is to serve as an engine of growth for the Asian region. Moreover, there is recognition that Japan and East Asia are in a community bound together by common economic interests. The Japanese Government acknowledged that the country's efforts for

10 Haruo Shimada, Professor of Economics, Keio University, 'The Prospect and Challenges of Japanese Economy, Politics, Society After the Financial Crisis in an International Perspective', 1999, <http://www.ndu.education/inss/symposia/pc99/shimada.html> (3 April 2000).

11 Marcus Noland, Sherman Robinson and Zhi Wang, International Economics Policy Briefs, 'The Depressing News from Asia', September 1998. See also Transcript: Deputy Secretary of the Treasury, Lawrence H. Summers 2/26 Q&A at Japan National Press CLUB, 26 February 1999.

12 Professor Peter Drysdale, *Committee Hansard*, 23 August 1999, p. 765.

13 Haruo Shimada, Professor of Economics, Keio University, 'The Prospect and Challenges of Japanese Economy, Politics, Society After the Financial Crisis in an International Perspective', 1999, <http://www.ndu.education/inss/symposia/pc99/shimada.html> (3 April 2000)

economic revival are extremely important for the stability and prosperity of Asia but, similarly, Japan cannot enjoy security and economic growth without the stability and prosperity of the Asian economy.¹⁴

8.15 Despite Japan's recognition of the need to improve its own economic performance, some in the international world complain that Japan is not matching its words with action. The United States has urged Japan to strive for significant rates of economic growth and has repeatedly insisted that an early restoration of growth is vital for Japan and the whole region. It warned Japan against the 'complacency of diminished expectations' and explained:

...a willingness to accept as adequate, growth in the one percent range, is to establish a pattern in which global growth may not be fully balanced and is to run the risks that if there are fluctuations, growth would again be negative.¹⁵

The G-7 Ministers meeting in Tokyo in January 2000 also called on Japan to further strengthen the financial system and to continue structural reforms.¹⁶

8.16 DFAT argued that it was possible to overstate the importance of Japan to the economic circumstances of South East Asian economies. It pointed out that the Japanese situation is not as critical to the recovery of a number of South East Asian economies as might be thought because Japan's importance as an export destination to a lot of economies has been declining over a long period of time. Mr Colin Haseltine told the Committee '...manufactures of crisis affected Southeast Asian economies comprise a much higher proportion of total exports into countries such as the US than they do in Japan'.

8.17 Nonetheless, DFAT acknowledged that, if the Japanese economy were to recover and to show strong positive growth, then that would clearly be an important factor. It believed that the value of the yen against the United States dollar, was probably where the impact on Southeast Asian economies would be the greatest. It suggested 'a stronger yen-US dollar rate would give regional Southeast Asian exporters a competitive edge relative to Japanese exporters'.¹⁷

14 Policy speech by Prime Minister Keizo Obuchi to the 144th Session of the Diet, 27 November 1998, <http://www.kantei.go.jp/foreign/souri/981204policy-speech.html> (19 October 1999). See also Takashi Imai, Chairman of Keidanren and Keizai Koho Center, 'Japanese and Asian Economies Recovering Together', Occasional Paper Series no. 8, Keizai Koho Center, January 1999.

15 USIA, Washington File, Transcript: 'Treasury's Summers Jan. 21 Pres Briefing in Tokyo', 21 January 2000, <http://www.usia.gov/cgi-bin/washfile/display.pl?p=/products/washfile/.../newsitem.shtm> (25 January 2000)

16 USIA, Washington File, 'Text: Statement of the G-7 Finance Ministers Tokyo Meeting', 24 January 2000, <http://www.usia.gov/cgi-bin/washfile/display.pl?p=/products/washfile/.../newsitem.shtm> (25 January 2000).

17 Colin Haseltine, DFAT, *Committee Hansard*, 15 February 1999, pp. 23–4.

8.18 Clearly, it is in the interests of the whole region for Japan to shake off its economic malaise as soon as possible.¹⁸ Without a strong and durable revival in domestic demand, Japan will not be able to provide an expanding market for other Asian economies. The United Nations Conference on Trade and Development (UNCTAD) maintained:

Recovery of the Japanese economy will be crucial to recovery in the rest of Asia.¹⁹

Direct aid to Asian economies in crisis

8.19 Since its economic slowdown, Japan has been preoccupied with domestic troubles. Yet, even in a time of economic adversity, Japan has not sat on the sidelines nursing its own economic wounds. It has been conscientious in searching for effective solutions to the Asian economic crisis.

8.20 Japanese leaders have openly and repeatedly stated that Japan would honour its responsibilities to help its neighbours overcome their economic difficulties and to assist in revitalising their economies.²⁰ Prime Minister Keizo Obuchi in August 1998, pledged strong support to those Asian economies under economic stress. He stated:

...Japan has responded seriously to the turmoil of the currency and financial markets of the Asian countries...Japan will continue to play a leading role toward the economic recovery of the Asian countries, providing all possible assistance.²¹

8.21 Japan worked closely with the IMF, World Bank and the Asian Development Bank to assist those Asian countries in economic trouble. From the beginning, the ASEAN countries and Japan agreed to consolidate further their close economic relations to help the region through this difficult time. As early as December 1997, the ASEAN member states publicly thanked Japan for its contribution to financing packages in the region.²²

18 For example see, Consul-General Shimanouchi, 'Economic Crisis in Asia and What Japan is Doing', May 1999 and Policy speech by Prime Minister Keizo Obuchi to the 144th Session of the Diet, 27 November 1998 <http://www.kantei.go.jp/foreign/souri/981204policy-speech.html> (19 October 1999).

19 United Nations Conference on Trade and Development, *Report, 1998*, Overview, p. vi.

20 Address by Japanese Prime Minister Keizo Obuchi to the 143rd session of the Diet, 7 August 1998, <http://www.infojapan.org/announce/announce/1998/8/807-0.html> (25 April 2000). See also Consul-General Shimanouchi, 'Economic Crisis in Asia and What Japan is Doing', May 1999; Sei Nakai, Senior Deputy Director-General of the International Bureau, Ministry of Finance, 'Efforts Toward Recovery of the Japanese Economy and Japan's Response to the Asian Currency Crisis', The National Investment Company Service Association, 1999.

21 Address by Japanese Prime Minister Keizo Obuchi to the 143rd session of the Diet, 7 August 1998, <http://www.infojapan.org/announce/announce/1998/8/807-0.html> (25 April 2000).

22 The Ministry of Foreign Affairs of Japan, Joint Statement of the Meeting of Heads of State/Government of the Member States of ASEAN and the Prime Minister of Japan, Kuala Lumpur, 16 December 1997. The ASEAN member states also thanked Japan in 1999 for its continued assistance. See Joint Ministerial Statement of the Third ASEAN Finance Ministers Meeting, Hanoi, 20 March 1999.

8.22 In February 1998, the Japanese Government announced an initiative to provide quick and adequate liquidity support for those Asian economies experiencing economic turmoil—‘Emergency Measures Placing Special Focus on Stabilizing Southeast Asian Economies’. The following April, it followed this initiative with additional support measures contained in its Economic Stimulus Package.

8.23 At this time, Japan, the largest contributor to international efforts to help Asian economies suffering from the economic crisis, provided financial assistance of over \$US40 billion to Indonesia, Thailand and Korea. Assistance in this package targeted four main areas:

- support for facilitating trade finance ‘two-step loans’ of Export-Import Bank of Japan;
- support for economic reforms by setting up an emergency special interest rate system for yen-denominated government credits with quick disbursement;
- improvement of support for human resource development such as receiving trainees and dispatching specialists; and
- support for securing basic necessities such as food and medical supplies (500 thousand tons of rice from government stock pile on loan, and 100 tons grant by aid).²³

8.24 This contribution to alleviate economic hardship by supporting the recovery of the Asian economies was further boosted in October 1998 with the announcement of the New Miyazawa Initiative. This initiative was to provide \$30 billion in financial assistance to five crisis hit economies in Asia—Thailand, Malaysia, the Philippines, Indonesia and Korea. Half of this sum was in the form of yen loans to promote economic recovery and the other half was to enrich financial reserves to meet the financial demand for economic reform.

8.25 In general, the measures were to assist Asia’s structural reform and human resources development and to alleviate the plight of the most disadvantaged sectors of the society with direct assistance in food and medical supplies. Mr Sei Nakai, Senior Deputy Director of the International Bureau, Ministry of Finance, provided details of this package:

With this initiative, Japan stands ready to provide a package of support measures for the recovery of the region’s real economies, which is the most urgent challenge facing the Asian countries. Financial assistance of \$15 billion will be made available to meet the medium-term and long-term financial needs of Asia; specifically, to strengthen the financial sectors; to promote economic recovery; to protect the vulnerable; and to resolve the credit crunch. Another \$15 billion will be set aside for possible short-term

23 Comprehensive Economic Measures, Ministry of Foreign Affairs of Japan, 24 April 1998, <http://www.mofa.go.jp/policy/economy/measure98/measures.html> (15 February 1999).

capital needs during the process of implementing economic reforms. Other measures, such as the provision of guarantees, to help Asian countries raise funds from international financial markets, also are included in this initiative.²⁴

8.26 The Miyazawa Initiative is providing an invaluable infusion of support to assist the region's nascent recovery and to provide assistance for achieving currency and economic stability in Asian countries.²⁵ This initiative stands as testimony to Japan's commitment to help the Asian economies restore their economies to good health.

8.27 As of May 1999, two-thirds of this assistance had been committed. Japan gave notice of its intention to continue to implement and even build on this initiative 'both in substance and in scope in the coming years'. Japan's Finance Minister, Mr Kiichi Miyazawa, stated that the government planned to extend financial support to Vietnam as well, apart from the \$30 billion previously announced.²⁶

8.28 As Asian economies such as the Republic of Korea, the Philippines, Thailand and Malaysia showed positive signs of recovery during 1999, Japan continued to offer support. In May 1999, at the APEC Finance Ministers meeting, Japan announced the 'Resource Mobilization Plan for Asia'—the second stage of the New Miyazawa Initiative. Japanese leaders could see that the economic turmoil of the past two years had subsided and that the region had entered a period of relative economic calm. It believed that the Asian economies, having passed through the initial stage of the economic crisis and the second stage of preventing further stagnation of their economies, were now entering a new stage of cooperation in the construction of a more stable and robust economy. To help them recover fully and to maintain steady growth, Japan announced that it stood ready to provide assistance to mobilise a total of ¥2 trillion of domestic and foreign private funds for Asia.²⁷

8.29 Many in the international community readily accept that no other country has matched Japan's generosity in providing assistance to countries affected by the Asian economic crisis.²⁸ It is also a source of international pride for Japan that it has

24 Sei Nakai, Senior Deputy Director-General of the International Bureau, Ministry of Finance, Japan, 'Efforts Toward Recovery of the Japanese Economy and Japan's Response to the Asian Currency Crisis', the National Investment Service Association, <http://www.us-japan.org/JapanBoston/nakai.htm> (3 April 2000).

25 See statements by Michel Camdessus, Managing Director of the International Monetary Fund, 'World Economic Outlook: Implications of Reform for Japan and the IMF', at the International Finance Seminar, 18 May 1999. Economic Planning Agency, 'Follow-up and Future Schedule for Implementation of the Emergency Economic Package: Pursuing the Revitalization of the Japanese Economy', 23 April 1999.

26 Speech by Mr Kiichi Miyazawa at the APEC Finance Ministers Meeting, Malaysia, 15 May 1999, <http://www.mof.go.jp/english/if/e1b068.htm> (4 April 2000).

27 Speech by Mr Kiichi Miyazawa at the APEC Finance Ministers Meeting, Malaysia, 15 May 1999, <http://www.mof.go.jp/english/if/e1b068.htm> (4 April 2000).

28 Colin Heseltine, DFAT, *Committee Hansard*, 15 February 1999, p. 3; DFAT, submission no. 32, p. 51.

accepted its responsibility as a major economy in Asia, and provided by far the largest amount of support for the crisis-affected Asian countries.²⁹

8.30 Mr Michel Camdessus, Managing Director of the International Monetary Fund, acknowledged the valuable assistance provided by Japan and noted its new program which dovetailed with Miyazawa's first initiative. He observed that the objective was to accelerate the full recovery of the countries and to facilitate their return to the international market. In assessing Japan's resource mobilization plan, he stated:

I think this was a well inspired and timely initiative. By doing that Japan demonstrates the role of leadership it must have in this part of the world and in the world in the future. I wanted to say that, seen from the point of view of the IMF with the responsibilities we have to speed up the recovery of all these countries, these initiatives are extremely welcome and this is an occasion for me to express my gratitude to Japan for its permanent support in all our labors to try to make the world economy a more prosperous one and one which offers to the poorest real chances of development.³⁰

8.31 Although Japan is offering substantial assistance to the Asian economies, many people, unlike Michel Camdessus, have criticised Japan for not providing the leadership necessary to guide Asia out of its difficulties. Given the dominance of its economic standing and its close relations with countries in the Asian region, many have argued that Japan has not made an appropriate contribution to regional development: that it has shunned its responsibility as a regional leader.

8.32 They were not referring to its assistance programs but to its commitment to restructure its economy. More specifically, they argued that Japan must show the way ahead by offering a strong and more open market to its neighbours. To this end, first of all, Japan itself must aggressively implement structural reform to realise robust economic fundamentals. They argued that at the same time, Japan should promote further opening and improvement of its domestic markets to contribute to the efficient and fair allocation of world resources. DFAT submitted:

...aid is a poor substitute for trade, and Japan should not expect its generous financial assistance to the region to shield it from criticism that its domestic difficulties are compounding East Asia's problems and threatening to delay its recovery.³¹

29 Sei Nakai, Senior Director-General of the International Bureau, Ministry of Finance, Japan, 'Efforts Toward Recovery of the Japanese Economy and Japan's Response to the Asian Currency Crisis', New Delhi, <http://www.us-japan.org/JapanBoston/nakai.htm> (3 April 2000).

30 Michel Camdessus, Managing Director of the International Monetary Fund, transcript of a Press Briefing at the Japan Press Club, 18 May 1999.

31 DFAT, submission no. 32, p. 51.

Professor David Reid told the Committee that Japan ‘has failed to lead Asia out of its peril and it has actually been part of the problem’.³²

8.33 Japan’s leadership in economic reform would not only provide markets for other Asian economies but stand as a model of economic restructuring that other countries in the region could follow. Dr Wendy Smith emphasised that Japan’s influence in the region extends beyond management systems, production systems and work ethics and that ‘the socio-cultural impact of Japan’s very high level of direct foreign investment in South-East Asian countries has been striking...’³³ Clearly, Japan is well placed to encourage countries in the region to undertake economic restructuring. Keidanren insisted that Japan must serve as a standard bearer for structural reform. It stated:

...whether it is in the area of adjusting national legal and taxation systems to globally practiced standards, developing a strategic industrial-technology policy for the future or overhauling the social security system. All this is to build the necessary underpinnings of renewed economic vibrancy. Simultaneously, we in Japan must strive to increase imports by expanding domestic demand with the government steadily applying measures to keep up the level of economic activity.³⁴

8.34 In the current situation, Japan should be at the vanguard in driving Asian economic recovery by offering a healthy, open market to its neighbour’s exporters. But for some it has been ‘a millstone around the neck of the world economy’.³⁵ The United States, in particular, would like to see Japan exert more leadership in pursuit of increased openness in the world trading system. Put succinctly, ‘Insular thinking in an economic powerhouse such as Japan can have negative effects worldwide’.³⁶

Implications for Australia

8.35 Australia’s economy has also been affected indirectly by economic developments in Japan through Japan’s trade and investment linkages in third markets, particularly in the East Asian region.³⁷ Australia’s exports to the rest of East Asia which accounted for 37% of its exports in 1997 have fallen sharply. According to DFAT:

32 Professor David Reid, *Committee Hansard*, 25 February 1999, p. 192.

33 Dr Wendy Smith, *Committee Hansard*, 17 May 1999, pp. 557–8.

34 Keidanren, ‘For Asia’s Economic Renewal: A Proposal by Japan’s business community’, 13 March 2000, <http://www.keidanren.or.jp/english/policy/2000/007/proposal.html> (31 March 2000).

35 United States Information Agency, Transcript: Deputy USTR Fisher—16 June Worldnet Program on APEC (U.S. to continue pushing trade liberalization at APEC), 17 June 1999.

36 See United States Information Agency, Transcript: Deputy USTR Fisher—16 June Worldnet Program on APEC (U.S. to continue pushing trade liberalization at APEC), 17 June 1999; Remarks of Ambassador David L. Aaron, Under Secretary of Commerce for International Trade before the American Chamber of Commerce of Japan, Tokyo American Club, 29 July 1999.

37 DFAT, submission no. 32, p. 65.

To the extent that the weaker Yen weakened regional currencies and threatened to delay recovery in the region, it weakened Australia's medium to longer term export growth prospects. Thus, Australia has supported US and Japanese efforts to stabilise the value of the Yen.³⁸

8.36 DFAT told the Committee that over the past year, Australia had been working very closely with Japan on the Asian economic crisis, with extensive exchanges on how best to assist some of the countries most seriously affected. It noted that Australia and Japan are the only two countries to have contributed to all three IMF packages to affected countries.³⁹

8.37 For many years, Japan and Australia have worked together to develop a framework that would promote economic cooperation throughout the Asia Pacific region. In 1976, that Prime Ministers of both countries signed a basic treaty of friendship which recognised that:

...co-operation between the two countries should have in view not only their own mutual benefit but also their common interest in the prosperity and welfare of other countries, including those in the Asian and Pacific region, of which we are a part.⁴⁰

8.38 Their persistence in seeking ways to develop greater regional cooperation was rewarded in 1989 with the inauguration of APEC, a forum of 12 Asia-Pacific economies, now grown to 21 members, with the stated goal of promoting a more open trading system. At that time, Australia recognised that a strong and open multilateral trading system was fundamental to the economic growth and prosperity of economies in the Asia-Pacific region. It still believes that this is the case and looks to Japan's continued support to promote free and open trade in the region.

8.39 More recently, Japan, as an advocate for trade and investment liberalisation, has been reluctant to assume a leadership role in fora such as APEC and WTO.⁴¹ Some countries feel a mounting disappointment with Japan's reticence to step forward. The rice tariff decision, the overall slow pace of regulatory reform and a general sense that Japan has pulled back from its commitment to free and open trade

38 DFAT, submission no. 32, p. 65.

39 Colin Heseltine, DFAT, *Committee Hansard*, 15 February 1999, p. 1; DFAT submission no. 32, p. 51. Mr Ian Macfarlane, Governor of the Reserve Bank of Australia, also observed that Australia, apart from Japan, was the only country to contribute to all three financial assistance packages. He stated further 'the Australian authorities were able to play a useful role because they had been building an understanding of regional developments for many years, in part reflecting the strong trade links with the region, but also a more general interest on the part of business and academic communities'. Speech to the Asia Pacific Forex Congress, Sydney, 27 November 1998, http://www.rba.gov.au/speech/sp_gov_271198.html (18 December 1998).

40 Basic Treaty of Friendship and Co-operation between Australia and Japan, signed in Tokyo 16 June 1976 and entered into force on 21 August 1977.

41 See Remarks of Ambassador David L. Aaron, Under Secretary of Commerce for International Trade before the American Chamber of Commerce of Japan, Tokyo American Club, 29 July 1999.

feeds that sense of dismay. Australia fears that an erosion of commitment by the larger economies, such as Japan and the United States, toward the global trading system would jeopardise progress toward greater trade and investment liberalisation.

8.40 A major worry is that Japan, troubled by its own economic problems, will turn increasingly inwards. A number of witnesses before the Committee noted that many Japanese feel threatened by globalisation and the increasing presence of foreign companies in their marketplace. They believe that it is destabilising and undermining their traditional social forms.⁴² Professor Morris-Suzuki pointed out that these misgivings fuel a growing public sense of nationalism. She told the Committee that there is widespread anxiety and concern in Japan about its future role in the world and growing criticism of neoclassical economics in Japan—of conventional economics which is seen by many people as being the cause of the contemporary crisis.

8.41 In summary, she suggested that ‘there is a feeling, certainly amongst some sections of the media and public, that Japan is losing control over its own financial system and over its own economy to some extent particularly to US based multinational enterprises’.⁴³ She saw this apprehension expressed at a public level rather than a national level for example reflected in an increasingly anti-American tone in the media.⁴⁴

8.42 Professor Drysdale also believed that the disquiet being generated in Japan by economic uncertainty has led to some contrariness in policy thinking. He submitted:

...the malaise in Japan and the East Asian crisis have, deep down, shaken policy psychology in Japan. Japan’s own economic fragility and incomplete structural reform provide fertile ground for contrarian thinking in the period immediately ahead...⁴⁵

8.43 He stressed that this type of thinking could influence foreign economic policy choices on regional and international arrangements and that Australia must work to ensure that Japan does not move toward policies contrary to Australia’s interest.⁴⁶ Japan’s retreat from its commitment to trade and investment liberalisation is of significant concern to Australia.

8.44 As noted in Chapter 6, Japan is sending confusing signals about its approach to trade and investment liberalisation. On the one hand it forthrightly defends a free

42 Professor Teresa Morris-Suzuki, *Committee Hansard*, 24 May 1999, pp. 601–2. See also views of David Askew, *Committee Hansard*, 17 May 1999, p. 545.

43 Professor Teresa Morris-Suzuki, *Committee Hansard*, 24 May 1999, p. 605.

44 Professor Teresa Morris-Suzuki, *Committee Hansard*, 24 May 1999, p. 601.

45 Peter Drysdale, ‘Where is the Japan Economy Heading’, Summary of APSEM Public seminar presentation, 19 May 1999.

46 Professor Peter Drysdale, *Committee Hansard*, 23 August 1999, pp. 767–8; and Professor Peter Drysdale, ‘Where is the Japanese economy headed?’, summary of APSEM Seminar Presentation, 19 May 1999.

and open global trading system but on the other holds back from further opening its markets. Professor Drysdale told the Committee:

I think the bottom line is that this fluidity in policy thinking in Japan presents a strong case for close and active engagement by Australia in dialogue with Japan on how these changes will effect our interests in Japan and in the Asia–Pacific region, and an even closer dialogue than we presently have, which is very close indeed.⁴⁷

8.45 Australia is also particularly concerned about being left out in the economic cold should the Asian countries form a trading bloc. Again, Australia hopes that Japan would oppose such a situation developing. So far, Japan has refused to endorse the proposed East Asia Economic Caucus (EAEC), a consultative body of East Asian countries seeking to enhance economic cooperation in the region. At the moment, this group has indicated no wish to include Australia in its circle.

8.46 Japan, however, has participated in the ASEAN + 3 forum. This gathering of Leaders of the ASEAN countries and of China, Japan and the Republic of Korea is an important step in developing dialogue and cooperation in the region. The leaders of China, Japan and Korea met as a group with those of ASEAN at the ASEAN summits in 1997 in Kuala Lumpur and in 1998 in Hanoi. Economic cooperation figures prominently in their talks.

8.47 At their gathering in Hanoi, the leaders, in a move to formalise the ASEAN + 3 as a regional forum, agreed on the importance of holding regular meetings to enhance the dialogue process and strengthen cooperation.⁴⁸ They met again in 1999 where the emphasis was on ‘cooperation and collaboration with each other, thereby strengthening the elements essential for the promotion of peace, stability and prosperity in the region’. Some, however, regard the ASEAN + 3 as a revived or recasted EAEC and harbour apprehensions of Australia being shut out of an

47 Professor Peter Drysdale, *Committee Hansard*, 23 August 1999, p. 768.

48 Rodolfo C. Severino, Secretary-General of the Association of Southeast Asian Nations, at the regional conference on ‘Common Currency for East Asia: Dream or Reality’, Penang, 5 August 1999, http://www.asean.or.id/secgen/sg_eac.htm (2 August 2000); Press Release, ‘ASEAN to Promote Comprehensive Development’, <http://www.asean.or.id/amm/amm33pre1.htm> (26 July 2000).

important Asian trading group.⁴⁹ It would be expected that Japan would resist any move by this group to form a preferential trading bloc.⁵⁰

8.48 Japan has also given support for Australia to be accepted as a member of the Asia-Europe Meeting (ASEM).⁵¹ Japan is proving itself a vital partner and valuable friend to Australia in Asia.

8.49 The Committee appreciates that Japan is going through a difficult economic transition that may lead some Japanese to question its commitment to promoting free and open trade in the region.

Recommendation

The Committee recommends that the Australian Government, through its numerous institutional arrangements with Japan and its network of political, official and business contacts, encourage Japan to step forward as a regional leader to guide and assist its neighbours to establish a more open trading system in the region.

The Japan–United States trade relationship

8.50 The Japan–United States relationship—a relationship between the two most powerful economies in the world—is the mainstay of the global economy and any tremors from a clash between these two economic giants would register around the world.

8.51 Japan’s relationship with the United States, its largest trading partner, forms the cornerstone of Japan’s foreign policy.⁵² The relationship, however, is complicated and not without friction. At times, underlying tensions build and then subside for a

49 The Ministry of Foreign Affairs of Japan, ‘Joint statement on East Asia Cooperation’, 28 November 1999; *Financial Review*, article by Bruce Cheeseman, ‘Mahathir finally wins push for East Asia trade zone’, 27 July and editorial, 28 July 2000; Manuel F. Montes, Kevin F.F. Quigley and Donald E. Weatherbee, ‘Growing Pains: ASEAN’s Economic and Political Challenges’, Asia Society Publications, December 1997, http://www.asiasociety.org/publications/asean_challengers.html (2 August 2000). See also Press Conference by the Press secretary, 11 December 1998, ‘Significance of the goals of the ASEAN Summit Meeting’, <http://www.mofa.go.jp/announce/press/1998/12/1211.html> (28 July 2000); Joint Communique of the Thirty Third ASEAN Ministerial Meeting, Bangkok, Thailand, 24–25 July 2000. See Report of the Senate Foreign Affairs, Defence and Trade References Committee, *Australia and APEC: A Review of Asia Pacific Economic Cooperation*, July 2000, paras 9.77–9.84.

50 See Report of the Senate Foreign Affairs, Defence and Trade References Committee, *Australia and APEC: A Review of Asia Pacific Economic Cooperation*, July 2000, para 9.79.

51 Yukio Satoh, ‘Japan-Australia Relations: Emerging Partnership’, Speech of the Japanese Ambassador at the Foreign Correspondents’ Association in Sydney, 1 November 1996.

52 For example see Address by Japanese Prime Minister Keizo Obuchi to the 143rd session of the Diet, 7 August 1998, <http://www.infojapan.org/announce/announce/1998/8/807-0.html> (25 April 2000). See also Policy speech by Prime Minister Keizo Obuchi to the 144th Session of the Diet, 27 November 1998.

while. According to Mr Peter Hartcher, the Japan–United States trading relationship appears in good shape, but ‘if you scratch the surface and talk to senior people in Japan, there is tremendous accumulation of resentment, of hostility’.⁵³ Over recent years, as the trade surplus with Japan has widened, the relationship has become strained.⁵⁴

8.52 The United States trade deficit with Japan, which had been shrinking from 1995, underwent a reversal in 1997 and ballooned in 1998. The statistics for 1998 show that Japan’s trading surplus with the United States increased by 14% and stood at \$US64,094 million. This increase contributed to a worrying overall trend in the United States trade deficit, which in 1998, amounted to \$US168,587 million, 53% above the 1997 figure. This sharp increase in the United States’ trade deficit creates an environment likely to foment resurgent protectionist tendencies in the United States.⁵⁵

8.53 In part, the United States trade deficit was driven by a significant fall in exports to countries with slow or negative economic growth such as Japan. Indeed, in 1998, reduced exports to Japan from the United States was the major factor behind Japan’s trade surplus with the United States.⁵⁶ To redress this imbalance, the United States urged countries such as Japan ‘to move forward to restore growth to their economies to help promote economic stability and growth in emerging economies’.⁵⁷

8.54 As the economic crisis in Asia deepened and Japan showed no signs of pulling itself out of its economic mire, the United States became increasingly impatient with Japan’s lack of aggression in tackling its domestic problems. In July 1998, Mr Richard Fisher, Deputy United States Trade Representative, noted:

In the past year, Japan has at times reminded me of an All-Star baseball player who, with the game on the line in the ninth inning and all the world watching, simply sits down and refuses to get into the batter’s box. We

53 Peter Hartcher, *Committee Hansard*, 15 April 1999, p. 340.

54 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 633. Austrade told the Committee that Japan’s trading surplus has increased by 23% and although Japan’s exports are down, its imports are down further. So Japan is losing on exports, but infuriating the Americans and other trading partners by buying much less from them.

55 Deficit figures in Bruce Odessey, USIA Staff writer, ‘1998 US Trade Deficit Sets Record; Trend Continues in ’99’, <http://usinfo.state.gov/topical/econ/new1.htm> (7 April 2000); See for example, International Monetary Fund, Press Conference by Michael Mussa on the Interim Assessment of the World Economic Outlook and International Capital Markets, 21 December 1998, <http://www.imf.int/external/np/tr/1998/TR981221.htm> (18 November 1999); and Marcus Noland, Sherman Robinson and Zhi Wang, International Economics Policy Briefs, ‘The Depressing News from Asia’, September 1998 and MITI, *White Paper on International Trade 1999*, Chapter 2, ‘The Changing Japanese Trade Structure and Recent Trade Trends’. Also and Christopher Pokarier, submission no. 10, p. 8.

56 MITI, *White Paper on International Trade 1999*, Chapter 2, ‘The Changing Japanese Trade Structure and Recent Trade Trends’.

57 Bruce Odessey, USIA Staff writer, ‘1998 US Trade Deficit Sets Record; Trend Continues in ’99’, <http://usinfo.state.gov/topical/econ/new1.htm> (7 April 2000).

expect more of our key ally in the Pacific and our largest Asian trading partner.⁵⁸

8.55 This frustration with Japan spilled over to public quarrelling when Japanese steel imports flooded the United States market in 1998.⁵⁹ The Japanese steel industry was hit hard by the economic downturn in both domestic and overseas markets and industrial production fell by some 7% in 1998. With demand in the Asian region collapsing and the currencies in most of the steel-producing countries in the region depreciating, Japan looked to other markets to absorb its excess in steel production. The Northern Hemisphere markets were swamped with what were cheap steel imports. In 1998, Japanese exports of steel to the United States soared to 6.1 million metric tons representing a 163.4% increase on the previous year.⁶⁰ According to Hamersley Iron:

The natural response of the steel industries in the Northern Hemisphere was to say to their governments, 'Let's put in place some antidumping actions or protectionist actions', and you can see in the United States already the United States government has imposed constraints on hot coil exports and they are looking at other actions on other areas like carbon steel.⁶¹

8.56 Indeed, the United States took decisive action in enforcing its antidumping and countervailing duty laws against Japan. It issued a strong warning informing the Japanese Government that the American Government expected steel imports to revert to pre-crisis levels. It told Japan:

...if such a roll-back does not occur in short order, the Administration would self-initiate trade action to ensure a reduction of imports and to prevent further injury to U.S. steel producers and workers. Thus, the roll-back will be enforced, if necessary, through Administration trade action. Our intent is to act forcefully if normal trade patterns are not promptly restored.⁶²

8.57 Although the acrimony generated by the dispute over Japanese steel imports has eased, the United States is still annoyed at Japan's seeming half-hearted

58 Text: Deputy USTR Richard Fisher on US-Japan Trade, Testimony of Ambassador Richard Fisher Deputy United States Trade Representative, House Ways & Means Trade Subcommittee Executive Session, 15 July 1998.

59 Colin Heseltine, DFAT, *Committee Hansard*, 15 February 1999, p. 2.

60 Text: Barshefsky to House Subcommittee on Steel Imports—Testimony of Ambassador Charlene Barshefsky, United States Trade Representative, to Trade Subcommittee of the House Committee on Ways and Means, 25 February 1999.

61 Philip Mitchell, Hamersley Iron Ltd, *Committee Hansard*, 24 February 1999, p. 90. Hamersley told the Committee that Japanese exports into the US in 1998 went up by 260% from roughly 2½ million tonnes to 8 million tonnes and exports into South-East Asia fell by about 24%.

62 Text: Barshefsky to House Subcommittee on Steel Imports—Testimony of Ambassador Charlene Barshefsky, United States Trade Representative, to Trade Subcommittee of the House Committee on Ways and Means, 25 February 1999.

commitment to promoting free trade. In May 1999, Ambassador Charlene Barshefsky noted:

For eight years, Japanese families, businesses and consumers have endured sluggish growth and stagnation; in the past two years, slowdown has become recession. This has complicated the efforts of Japan's neighbors to recover from the crisis, as Japanese imports dropped significantly last year. It has also increased the potential for trade tensions as U.S. exports to Japan have dropped and the trade imbalance has grown.⁶³

Put succinctly she stated, 'Last year's import surge has raised immense frustration in Congress and industry. It is hard to overstate the tension in the U.S. surrounding this issue'.⁶⁴

8.58 The United States did not hold back from further chiding Japan and in July 1999 warned:

Frankly, the growth of the trade imbalance since 1997 is reminiscent of past strategies to get well by intensifying efforts to export to the US. But I can assure you that the long-term effects—both political and economic—will be unfortunate for our relationship.⁶⁵

8.59 In early 2000, the United States told the Japanese that more needed to be done to open its markets. It cited in particular the public construction market. The United States Under Secretary of Commerce for International Trade pointed out that in 1999 American companies were only awarded \$50 million (0.02%) worth of contracts in Japan's \$250 billion public works market.⁶⁶

8.60 This trade dispute between the United States and Japan has implications for the global economic system and for Australia. At a time when the international economic system is looking for direction to take it further along the path to trade and investment liberalisation, the major economies, such as Japan and the United States, are not providing guidance, indeed they have got caught up in their own trade squabbles. Already both APEC and the WTO have stepped back from a determined effort to see a further opening of trade, particularly in the area of agriculture, a sector of most concern to Australia.

63 Ambassador Charlene Barshefsky, United States Trade Representative, Tokyo American Center, Tokyo, Japan 13 May 1999, <http://www.usia.gov/regional/ea/apec/barsh513.htm> (23 July 1999).

64 Ambassador Charlene Barshefsky, United States Trade Representative, Tokyo American Center, Tokyo, Japan 13 May 1999, <http://www.usia.gov/regional/ea/apec/barsh513.htm> (23 July 1999).

65 Secretary of Commerce for International Trade before the American Chamber of Commerce of Japan, Tokyo American Club, 29 July 1999.

66 USIA, Washington file, 'Text: Trade Administration News Release on Japanese Construction', 14 January 2000, <http://www.usia.gov/cgi-bin/washfile/display.pl?p=/products/washfile/.../newsitem.shtm> (25 January 2000).

8.61 The lack of leadership by the United States, Japan and the European Union helped to undermine progress at the WTO meeting in Seattle. Mr Robert G. Lees, Secretary General of the Pacific Basin Economic Council, noted:

These nations should be setting the model for the WTO in trade and investment liberalization. Instead, they seem to be all too frequently mired in drawn out and acrimonious debates and disagreements over politically charged trade issues. It is time for the leaders to lead, to finally put aside petty bickering, and to implement free trade in practice as well as theory.⁶⁷

8.62 The Committee reiterates its belief that Australia must seek the assistance of other countries to collaborate in helping to restore confidence in the WTO process.

8.63 Australia could also suffer through managed trade negotiations between the United States and Japan. Japan has a number of bilateral agreements or understandings with the United States on increasing market access or reducing trade barriers which cover goods such as automobiles and automobile parts, semiconductors, financial services and insurance.⁶⁸ Australia competes with the United States on a number of levels for a share of Japan's market, particularly in the agricultural sector. It is possible that Australia's trading interests could be harmed by measures taken by Japan to redress the trade imbalance as was the case in the early 1990s.

8.64 By the beginning of the 1990s, trade friction between Japan and the United States was mounting as the United States became increasingly concerned about its persistent trade deficit with Japan. As part of bilateral trade framework talks to resolve this trade imbalance between the United States and Japan, the United States was looking to facilitate the entry of its manufactured and auto parts to the Japanese market. According to Mr Jamie Anderson:

Australia feared that this bilateral managed trade policy could be a disaster for Australian exports, not only in the auto parts sector, but in other sectors as well. It was feared that if the US pushed hard enough for access to the Japanese market for US industries, the Japanese would accommodate their major trading partner partly by squeezing out the products of other, less important trading partners such as Australia.⁶⁹

8.65 Although the Australian Government took steps to ensure that the United States–Japan auto and auto parts agreement was settled on a most favoured nation (MFN) basis in a multilateral forum, a number of Australian economists believe that the agreement resulted in a 'Japanese import regime that discriminates against

67 Robert G. Lees, 'Report from Seattle', Secretary-General's Letter, in *Pacific Journal*, February 2000.

68 WTO Trade Policy Review of Japan, 19 January 1998, <http://www.tradepolicy.com/tradenews/0000000d.htm> (21 February 2000).

69 Jamie Anderson, 'Australia's Market Access Agenda Towards Japan', *Pacific Economic Paper no. 291*, May 1999, p. 12.

Australian and other non-American exporters of auto parts'. It would seem that private Japanese companies responded to United States' pressure by diverting trade from other countries such as Australia.⁷⁰

8.66 In the present situation, with the United States' trade deficit with Japan again growing, the United States might apply pressure on Japanese policy makers to accept more United States' exports. Thus, it is important for Australia to recognise that the growing tension between Japan and the United States could damage its trading position and hence Australia must ensure that it maintains its position in the Japanese market.

8.67 This commercial interconnectedness between the United States, Japan and Australia is made more complicated because to a large extent Australia's trading dependence on Japan is a dependence through Japan rather than on Japan. Mr Timothy Marney, Treasury Department of Western Australia, pointed out that, in the main, Japan's export performance determines its industrial production, which in turn determines the demand for Australian commodities. The United States, as Japan's main market, is a key in this trading link. Mr Marney told the Committee that in essence what Australia supplies to Japan is transformed in a manufacturing process and then exported to other markets, 'so the performance of other markets is crucial'.⁷¹

Recommendation

The Committee recommends that the Australian Government take careful note of the trade tensions that exist between the United States and Japan and maintain and strengthen dialogue with both countries to ensure that any attempt by the US to use political leverage to negotiate a managed trade agreement or arrangement with Japan does not harm Australia's interests.

The China–Japan trade relationship

China's growing economy

8.68 Mr C. Fred Bergsten pointed out that political rivalries pose a daunting barrier to effective cooperation in the Asia Pacific region. He argued that at the highest level of geopolitics, China, trying to maintain an authoritarian regime while embracing market economics, and Japan, an established democracy for over half a century, are

70 See Jamie Anderson, 'Australia's Market Access Agenda Towards Japan', *Pacific Economic Paper no. 291*, May 1999, p. 113 and Julia Lowell, 'Free Trade Champion? Australian Views of the US Trade Crusade against Japan', *Pacific Economic Paper no. 295*, September 1999, pp. 15–16.

71 Timothy Marney, Treasury Department of Western Australia, *Committee Hansard*, 25 February 1999, p. 161. See also Julia Lowell, 'Free Trade Champion? Australian Views of the US Trade Crusade against Japan', *Pacific Economic Paper no. 295*, September 1999, p. 15.

clearly competing for the leadership of Asia.⁷² Some witnesses can see a rocky phase ahead for the next decade in the Japan-China relationship.⁷³

8.69 Clearly, the emergence of China as an economic force in the region creates problems for both the United States and Japan and again has far reaching implications for Australia. Mr Pokarier observed:

Japan is increasingly over time going to have to figure out how it is going to balance a more influential China in the region with its close relationship with the United States. That will really fundamentally depend on how the US strategises China.⁷⁴

8.70 As economic interdependence among these three countries intensifies, the United States and Japan will look to China as a regional partner and leader. The United States and Japan recognise the importance of engaging China in the region and the challenge before them is to be part of the process that sees this nation incorporated into the region as a 'peaceful, prosperous and constructive partner'.⁷⁵

8.71 As noted by a number of economists:

How a fully developed and thus powerful China will choose to play its role in the world economy is one of the biggest unknowns of the next generation. But in all likelihood, China will learn about its new role by sharing responsibilities with the US and Japan to safeguard growing common interests of all three.⁷⁶

8.72 Along similar lines, DFAT acknowledged that the relationship between China and Japan has been uneasy through most of the past 100 years. Dr Richard Rigby, Assistant Secretary, North Asia Division, told the Committee that both countries have 'a very clear understanding that there is a need for a strong and basically good relationship between the two of them'. In summary, DFAT submitted that despite irritants in the relationship, Japan felt confident that it could manage relations with

72 C. Fred Bergsten, 'The New Asian Challenge', *Institute For International Economics Working Paper 00-4*, March 2000, <http://iie.com/CATALOG/WP/2000/00-4.htm> (8 June 2000)

73 See for example David Askew, *Committee Hansard*, 17 May 1999, p. 545.

74 Christopher Pokarier, *Committee Hansard*, 16 April 1999, p. 436.

75 USIA, Washington File, 'Text: Ambassador Foley Remarks to Foreign Correspondents Club of Japan', 18 January 2000, <http://www.usia.gov/cgi-bin/washfile/display.pl?p=/products/washfile/.../newsitem.shtml> (25 January 2000). See also Professor Tessa Morris-Suzuki, submission no. 3, p. 5; and the views of Peter Hartcher, *Committee Hansard*, 15 April 1999, p. 340.

76 Michael Borrus, Stephen S. Cohen and John Zysman, 'The American Perspective on the Liberalization of Trade and Investment', The Policy Study Group on China-Japan-US Cooperation in Asia-Pacific Regional Trade and Investment Liberalization, Interim Report, 1998, <http://socrates.berkeley.education/~briewww/pubs/wp/135.htm> (12 January 2000).

China 'in a way which is mutually beneficial to both countries and which in turn is beneficial for the whole Asian region'.⁷⁷

8.73 The Committee once again draws attention to its report on APEC where it highlighted the value of this organisation as a regional forum whose influence has spread beyond the boundaries of trade. The report noted that through dialogue and cooperation, APEC has built up a reservoir of good will and understanding between members and established a network of deepening diplomatic relations.⁷⁸ APEC provides an ideal forum in which members such as the United States, Japan and China can manage their relationship in a spirit of cooperation. According to a group of parliamentarians, academics and media analysts attending a workshop on the region, APEC is a forum uniquely suited to deal with the complicated strategic interactions in the Asia Pacific. It found that:

Australia and Japan should act to keep other member economies, particularly the US and China, actively engaged in the APEC process and to recognise the powerful informal role that APEC plays in promoting peace and security in the region.⁷⁹

8.74 The Committee recognises that Australia's role in influencing the triangular relationship between Japan, the United States and China is limited. It does see a role though for APEC in providing a forum that can facilitate or promote a cooperative approach by the three countries not only toward achieving the goal of free and open trade and investment in the region but to assist China in its economic integration in the region.

Recommendation

The Committee recommends that the Australian Government take an active part in persuading other APEC members, especially Japan, to become more actively engaged in the APEC process with the aim of strengthening regional cooperation and enhancing dialogue between member economies.

77 Dr Richard Rigby, DFAT, *Committee Hansard*, 15 February 1999, p. 13; DFAT, submission no. 32, p. 52.

78 See Report of the Senate Foreign Affairs, Defence and Trade References Committee, *Australia and APEC: A Review of Asia Pacific Economic Cooperation*, July 2000, paras 2.149 and 2.150.

79 Yoichi Funabashi and Peter Drysdale, Report on a Roundtable discussion 'Australia-Japan New Initiative for APEC 1999', July 1999.

CHAPTER 9

UNDERSTANDING AND PARTNERSHIP

Introduction

9.1 In this chapter, the Committee draws together some of the broader themes developed during the inquiry. In doing so, it turns its attention to Australia and how Australians can work to improve their relationship with Japan. The Committee looks specifically at the need to develop a strong mutual understanding between the two countries so they can develop a fruitful and lasting partnership.

Commitment to deepening the Australia-Japan relationship

9.2 The Committee does not accept that the Australia-Japan relationship has reached a low point and that the relationship is ‘floundering’. It does, nonetheless, take careful note of the warning given by some witnesses about complacency creeping into the relationship and acknowledges the call for Australia to work harder toward cultivating its relationship with Japan. As a first step, the Committee fully endorses the view that Australia needs to reaffirm its commitment to Japan.¹ But, it also recognises that practical measures must be taken to give substance to any reaffirmation and this means acknowledging any problems in the relationship and cooperating with Japan to reach solutions. It also means accepting that the Australia-Japan relationship must go beyond political pronouncements and diplomatic exchanges and that much work still needs to be done toward further developing the relationship particularly at the business level and in the general community.

9.3 Trade is not solely about economics and, as noted by a number of witnesses, trust and partnership are integral to any trading relationship. Mr Leon Wolff suggested that Australians need to strive for a higher level of sophistication and to achieve a degree of openness and trust in the Australia-Japan relationship.² Professor William Coaldrake made the point:

You may profit more by treating people not as products and as markets but as collaborators in the long term.³

9.4 In reaffirming its commitment to the Australia-Japan relationship, Australia needs to convey a clear message to Japan that it is prepared to stay for the long journey in developing and deepening their association. A number of witnesses submitted that Australians should be ‘patient with Japan as it finds its way through a

1 See Terence White, Australia-Japan Foundation, *Committee Hansard*, 19 February 1999, p. 51.

2 Leon Wolff, *Committee Hansard*, 28 May 1999, p. 647.

3 Professor William Coaldrake, *Committee Hansard*, 17 May 1999, p. 582.

maze of economic, political and social challenges'.⁴ Mr Wolff told the Committee that, 'If we pressure for immediate results, I think we will get band-aid solutions, but if we are prepared to discuss and engage with Japan over the medium and longer term, we will get something far stronger.'⁵ The Committee agrees.

9.5 Indeed, it is in Australia's wider interest to be as tolerant and sympathetic as possible on matters where Japan has real or perceived vulnerabilities. Australia should offer reassurance and show its readiness to assist Japan through this time of economic difficulty and change but at the same time it must show it is prepared to take a firm stand on matters of principle when its own interests are under threat. The recent issue over the tariffication of rice provides an example of the delicate balance required between supporting a trading partner and protecting national interest.

The need for both partners to develop an understanding of the other

9.6 Evidence presented to the Committee overwhelmingly reinforced the view that, to assess accurately the nature of the Australia-Japan association and then to take the relationship forward, both countries must have a genuine appreciation of how the other works. Knowledge of society, politics, economics and of law lay at the heart of developing a greater mutual appreciation between the two countries. Improving diplomatic and problem solving skills, particularly the ability to analyse current issues across a range of disciplines, is also important.⁶

9.7 In turning more specifically to safeguarding and promoting Australia's economic interests, witnesses emphasised the need to be able to comprehend fully what is happening in Japan. Indeed, one of the most consistent messages coming out of the inquiry was the need for Australians to have an understanding of the overarching socio-political architecture that shapes the trade policies of Australia's most important trading partner.

9.8 When Australians become disappointed with Japanese decisions, this reaction often stems from a misunderstanding of how Japanese society works—of unrealistic expectations. According to Mr Christopher Pokarier, Australians do not pay attention to interest group dynamics in Japanese politics. He stated:

If we had watched much more closely just how much their rural interests were hurting and had seen the political vulnerability of the LDP...it would not have surprised us...they would not have dared risk alienating their rural constituencies. If we had that in mind, we would not have been so shocked by the rice tariffication decision.

...

4 Christopher Pokarier, submission no. 10, p. 15.

5 Leon Wolff, *Committee Hansard*, 28 May 1999, p. 646.

6 Leon Wolff, *Committee Hansard*, 28 May 1999, p. 647.

...lots of people can understand in a general sense why farmers would want to protect their economic interests, but I do not think there is a broad understanding of how they make their interests politically salient in Japan. I think that is really the crux of it; that we should be better political economists more than anything else.⁷

9.9 The need to be fully aware of developments in Japan and to be able to assess how they will influence Australia is vital to Australia's interests especially at this time of rapid change and economic uncertainties. Professor Drysdale highlighted the importance for Australia to develop a clear understanding of the big changes that are taking place in Japan now, since 'misreading those changes in our largest economic partner would potentially damage our long-term strategic interests in the region and internationally'.⁸ The Australia-Japan Foundation loudly endorsed this view. It believed that Australia has to be very clever about the way it changes its trading relationship with Japan as it moves out of heavy industry.⁹

9.10 As pointed out by DFAT:

We need to continue to review that relationship to ensure that it retains its momentum and grows and develops to embrace new opportunities which come about as a result of change in both our societies. This includes exploring new commercial and other links going beyond the traditional areas to include challenges in IT, financial services, health and medical care and so on.¹⁰

9.11 Clearly, in this environment of change; of restructuring; of shifting trading patterns and economic uncertainties; Australia needs at hand the resources and skills necessary to understand and analyse the nature of the changes in Japan and their ramifications for the Australian economy. DFAT suggested that this level of understanding and analysis can be achieved through 'the maintenance and strengthening of current institutional arrangements and furtherance of high-level political, official, business and people-to-people contacts'.¹¹ The Committee agrees and has made recommendations along these lines in Chapters 6 and 7. A number of witnesses, however, went to the very fundamentals of the relationship—Australia's level of understanding of the culture, traditions and beliefs that shape Japanese society and guide its decision makers.

Understanding through language

9.12 One of the most notable advances that Australia has made in attaining a better understanding of Japan is through the teaching of the Japanese language in Australian

7 Christopher Pokarier, *Committee Hansard*, 16 April 1999, pp. 429–430.

8 Professor Peter Drysdale, *Committee Hansard*, 23 August 1999, p. 763.

9 Terence White, Australia-Japan Foundation, *Committee Hansard*, 19 February 1999, p. 47.

10 Colin Heseltine, DFAT, *Committee Hansard*, 15 February 1999, p. 4.

11 DFAT, submission no. 32, p. 6.

schools. Indeed, the Japanese language has become a popular area of study in Australia.

9.13 Professor Rix told the Committee that Australia has invested an enormous amount in learning about Japan and working with Japan. He drew special attention to the Japanese language programs in Australia's education system, the breadth of the study of Japan in the tertiary sector at universities, and the array of capacity within the government in dealing with Japan. In the last 25 years, he argued, Australia had 'come an enormously long way' in teaching Japanese language. He told the Committee that Australia is well served at the diplomatic level in Japan, noting that the embassy in Tokyo is one of the best embassies in terms of linguistic capacities of any in that city.¹²

9.14 The Japan Foundation told the Committee that there are more than 300,000 students of Japanese language in Australia. A similar survey from 1993 showed that there were around 180,000 students of Japanese. Over this 5-year period there has been a 70 per cent increase in the number of Australian students choosing to learn the Japanese language. As a percentage of the population, Australia ranks second behind Korea in the number of Japanese language students. Korea has more than 940,00 students studying the Japanese language.¹³

9.15 Closer scrutiny reveals, however, that 97 per cent of those studying the Japanese language in Australia are at primary and secondary school levels.¹⁴ According to the Department of Education over 5,000 students a year, or one in 60 of the students who have studied Japanese language at school, go on to take Japanese as part of their year 12 assessment that is at the higher school certificate level.¹⁵

9.16 The Japan Foundation Language Centre was concerned that although the number of students has increased in the primary and secondary levels, the ratio of students to teachers 'indicates that there is room for improvement'. It quoted 1998 figures to show that the increase in teachers of the Japanese language was only 39 per cent as compared with the 70 per cent increase in student numbers. It concluded that there is a shortage of suitably qualified teachers at the primary and secondary schools.¹⁶

12 Profesor Alan Rix, *Committee Hansard*, 16 April 1999, p. 447.

13 Katsumi Kakazu, Japan Foundation, Sydney Language Centre, *Committee Hansard*, 3 September 1999, p. 822 and David Askew, *Committee Hansard*, 17 May 1999, p. 552.

14 Katsumi Kakazu, Japan Foundation, Sydney Language Centre, *Committee Hansard*, p. 822.

15 Robert Horne, Department of Education, Training and Youth Affairs, *Committee Hansard*, 28 May 1999, p. 715.

16 Paper prepared by Katsumi Kakazu, Manager, the Japan Foundation Sydney Language Centre, p. 2.

9.17 The Foundation was also concerned that the high number of students undertaking Japanese language studies at school level are not successfully carrying through to the tertiary sector.¹⁷

9.18 Without doubt, Australia has made great strides in encouraging the study of Japanese language although the problem about the shortage of qualified teachers in Australian schools needs to be addressed. In turning specifically to tertiary institutions, however, the Committee noted that that area of Japanese studies needs careful review.

Understanding through appreciation of society and culture

9.19 A number of witnesses stressed that while language provides a solid base it alone is not sufficient to provide the level of understanding needed to comprehend fully the way a society works. Professor Coaldrake made the point that the very foundation of an enduring relationship rests on understanding and communication, which in turn depends upon speaking a language of mutual comprehension, not just each other's language, but also understanding society, culture and history. The idea of trust and partnership has great meaning for the Japanese so the level of understanding of its society and culture is particularly important. Professor Coaldrake argues that the disciplines of the social sciences and humanities will equip Australia best in the long term, along with strategic investment in science, technology, economics and political science, to analyse and anticipate trends in Japan.¹⁸ But according to him this vital area of study is being neglected and he could see a serious problem in the making. He told the Committee:

Efforts at governmental and university levels to respond to the surge in demand for Japanese language teaching in the mid-1980s addressed the crisis in language but the concentration of resources on language turned the medium into the message. It diverted resources away from teaching and research in the humanities and social sciences and caused a drop in academic staffing in Japanese studies.¹⁹

9.20 This trend away from the social sciences disturbed him. He pointed out that 'the implications of these indicators for the next generation in terms of our ability to position ourselves to understand Japan, are, quite frankly, frightening'. He stated that there were now insufficient new researchers entering the fields even to achieve replacement of the present inadequate numbers when the current generation of academics in the humanities and social sciences in Japanese studies moves on in 15, 20 or so years. He predicted that:

17 Katsumi Kakazu, Japan Foundation, Sydney Language Centre, *Committee Hansard*, 3 September 1999, p. 825.

18 Professor William Coaldrake, *Committee Hansard*, 17 May 1999, p. 574.

19 Professor William Coaldrake, *Committee Hansard*, 17 May 1999, p. 574.

The next 15 years will be spent in increasing intellectual isolation for Australia as momentum is lost. Australia's capacity to anticipate and analyse is crumbling.²⁰

9.21 The Japan Foundation Language Centre was also concerned that the study of Japanese culture was being neglected by Japanese language students. Put bluntly, Mr Katsumi Kakazu from the Japan Foundation Sydney Language Centre, stated: '...it is very important to learn language to communicate smoothly, but the other most important thing is to learn the culture of a country'. He pointed out that Japanese language and Japanese studies should be integrated because the language is inseparable from the culture and suggested that Australia must focus on a combination of study and research of some of the other aspects of the culture of the Japanese people.²¹

9.22 Dr George Mulgan endorsed these views on the significance of Japanese studies and supported other witnesses who were not happy with the level of knowledge and skill in Australia needed to monitor and assess accurately developments in Japan. She stressed the importance of having Japanese language if Australians want to have the quality of expertise necessary to engage effectively with the Japanese. But she went further to emphasise that a lifetime commitment is required to obtain that level of knowledge and understanding which calls for a strong involvement in Japanese studies as well. In considering tertiary institutions, she stated that the right balance was needed between strong Japanese language programs and strong Japanese studies programs. Moreover, that a greater degree of flexibility and encouragement was needed to allow 'some of the academic experts and scholars who work on Japan in Australian universities to go into the bureaucracy, to be seconded in and move back and forth'.²²

9.23 In particular, she felt that more expertise is needed within the Australian bureaucracy. She argued:

We certainly need a greater expertise in the agricultural bureaucracy to understand the nature of the farm lobby in Japan, that politics dictates agricultural policy in Japan.

...

The main problem with people in bureaucratic positions is that they are working very much to immediate issues and immediate questions that have to be dealt with. They do not have a chart; they do not have an opportunity

20 Professor William Coaldrake, *Committee Hansard*, 17 May 1999, p. 574.

21 Katsumi Kakazu, Japan Foundation, Sydney Language Centre, *Committee Hansard*, 3 September 1999, pp. 825, 827.

22 Dr Aurelia George Mulgan, *Committee Hansard*, 28 May 1999, p. 688.

to sit back and do some sort of more reflective work that can take place in academia.²³

9.24 Professor Coaldrake also drew attention to the inadequacy of combined degrees to equip graduates with the high level skills needed to successfully represent Australia's business interests in Japan. He argued that the requirements of combined degrees load the curriculum so that students are only able to achieve an elementary level of language and are not able to proceed beyond that standard to the really professional levels needed. He submitted:

...by creating combined degrees we have sent the signal of the Asian El Dorado. If you combine say, Japanese with economics you can write your own ticket...students do not pursue discipline studies on Japan. They pursue language and then they pursue economics but they do not necessarily combine the two very closely. The result is that we are losing out on both. We are losing out on the language and we are losing out on the disciplines.²⁴

9.25 Professor Yoshio Sugimoto was equally concerned about the failure of Japanese language students to combine effectively their language skill with another discipline. He acknowledged that the Japanese language programs had grown in number and quality over the last several years. He was critical, however, that those who had mastered the Japanese language at a semi-native level remained few and many Japanese language students in Australian universities complete their language course without obtaining another discipline based on professional training. He told the Committee:

...Japanese language programs have produced quite a lot of students with basic proficiency. They may satisfy some demand of the hospitality industry but, for long-term Australia-Japan relations, we need a lot more sophisticated language users among business and labour leaders as well as among technocrats and professionals. It seems to me that a numerical expansion of elementary Japanese language users has not been accompanied by the expansion of the number of Japan specialists equipped with both professional skills and top level Japanese language competency.²⁵

9.26 In other words, those who are capable of speaking the Japanese language after studying Japanese language courses in tertiary institutions are simply language specialists who do not have any other professional skills such as degrees in law, business administration or engineering. According to Professor Sugimoto, such graduates can cater for the low end of the hospitality industry and the tourism industry. On the other hand, those who have studied Japanese business, politics, society and so on may be intellectually quite well equipped in acquiring the knowledge of Japan, but they are not good language users. He recommended that

23 Dr Aurelia George Mulgan, *Committee Hansard*, 28 May 1999, p. 687.

24 Professor William Coaldrake, *Committee Hansard*, 17 May 1999, p. 575.

25 Professor Yoshio Sugimoto, *Committee Hansard*, 17 May 1999, p. 521.

some way be found to ensure that professionally oriented students who seek degrees and qualifications in professional areas can be trained to a higher level of language skills. He submitted:

If Australia can produce not necessarily a large number of experts but a small number of technocrats, business people and labour leaders who can cope with these two dimensions at a very high level of expertise, then we would be somewhere in handling Australia-Japan relations in a very efficient and outstanding way.²⁶

9.27 Mr Leon Wolff, argued that the groundwork that has been done with language is going to help Australians now but he also acknowledged that this is only the beginning. He followed the same argument as Dr Mulgan who highlighted the advantages to be gained by deepening the knowledge and understanding of Japan through a greater exchange of Japanese experts between various sectors of the community. He told the Committee:

If we want more Australians to really penetrate Japan, become critically engaged with Japan and understand and even predict the issues in Japan, we need to combine both the real world experience where they get the skills—where they know how to trade or they know comparative advantage—with them coming back to research. How things work economically in Australia with our distribution system is not necessarily going to translate with the same results in Japan, which has a different system. If they think about that, they will be better equipped to help Australia in the future.²⁷

9.28 Thus, despite successful efforts to encourage Australian students to pursue studies in the Japanese language, Australia is yet to go that step further and produce graduates who are able to combine language skills with expertise in another discipline such as politics, law, economics, or engineering. According to Professor Drysdale, 'Australia has made quite a substantial investment in training young people to do business with Japan, but the reality is that the scale and structure of knowledge required are still inadequate to the task'.²⁸

9.29 The Committee agrees that Australia needs to preserve and improve its institutional links with Japan and to work hard at developing contacts between Australians and Japanese at all levels from the official through to the community. But to acquire the high level skills necessary to assess and forecast trends in Japan, Australia needs to make a serious commitment over many years to train Australian

26 Professor Yoshio Sugimoto, *Committee Hansard*, 17 May 1999, p. 528.

27 Leon Wolff, *Committee Hansard*, 28 May 1999, pp. 647–648. See also Professor Gavan McCormack, *Committee Hansard*, 24 May 1999, p. 625. He stressed it was important to have a small cadre of highly trained and highly competent people who basically function in Japanese just like Japanese people do and that Australia had few such qualified people.

28 Peter Drysdale, Nancy Viviani, Akio Watanabe and Ippai Yamazawa, *The Australia-Japan Relationship: Towards the Year 2000*, Australia-Japan Research Centre and Japan Center for Economic Research, Canberra and Tokyo, September 1989, p. 12.

specialists to a standard that will fully equip them to provide sound advice and to make decisions regarding commercial undertakings in Japan. These researchers need to develop an intimate first-hand knowledge of the domestic socio-political framework in which trade policies are developed. They need to understand the socio-political realities that constrain the trade policies of Japan to be able either to advise on or to negotiate market agreements.²⁹ A real understanding of the sensitivities of operating in Japan is needed to underpin the development and formulation of strategies that will minimise the risk of unfavourable trade policy changes. Such an understanding will allow and encourage Australians to take full advantage of opportunities as they arise in Japan.

9.30 The Committee acknowledges and commends the great strides that have been made to encourage the study of Japanese language in Australia. It accepts, however, that more could be done to encourage students to study the language at the tertiary level and to combine this discipline with Japanese studies and with other disciplines.

Recommendation

The Committee recommends that the Australian Government introduce incentive schemes, such as scholarships, to encourage tertiary students to undertake the study of Japanese language combined with Japanese studies.

The Committee also recommends that the Australian Government offer incentive schemes to encourage graduates with Japanese language qualifications to undertake study in another discipline or graduates trained in disciplines such as economics, science or law to undertake Japanese language and studies.

9.31 The Committee takes note of the importance in investing in the long-term and on-going development and training of Japanese experts in Australia. It recognises the importance in providing opportunities for specialists in Japanese language and Japanese studies to move with greater flexibility among business organisations, public service and research institutions in Australia and to participate in exchange programs with counterparts in Japan.

Recommendation

The Committee recommends that the Australian Government adopt a policy that clearly encourages and facilitates the exchange of academics, business people and public servants with expertise or experience in Japan among business organisations, public service and research institutions in Australia and between counterparts in Australia and Japan.

29 David Longworth, 'Understanding our Customers: Hidden socio-political realities in Japan and China which influence trade with Australia, *Australasian Agribusiness Review*, vol. 1 no. 1, May 1993, p. 27.

Role of government

9.32 The Australian Government has an active and positive role in encouraging trading links with Japan. There is a need for government officials to understand the changes in Japan so they can anticipate and forecast trends to assist exporters in taking advantage of these changes, especially in negotiating market agreements.

9.33 The Committee has detailed in Chapters 6 and 7, the Australian Government's involvement in fostering a close partnership in which commercial life can flourish between the two countries. It has noted the steps taken by the Australian Government to facilitate trade with Japan, such as its contribution to Japan's Deregulation Program and the appointment of specialists to Japan to assist in quarantine matters as well its work at the regional level as a member of APEC.

9.34 This involvement is concerned with removing specific obstacles to trade. The government also has a vital role to ensure that Australian producers are well placed to take advantage of opportunities arising in the Japanese marketplace; to be involved in directly supporting and assisting Australian exporters in their endeavours to gain access to the Japanese market.

9.35 In Chapter 7, the Committee underlined one of the strongest messages coming out of the inquiry—the importance for Australian exporters to know their customers, to be fully informed about developments in the Japanese markets and to be aware of future trends. Many witnesses before the Committee believed that the Australian Government could be a catalyst not only in maintaining information flows but in motivating Australian producers to trade with Japan and in facilitating such trade ventures.³⁰

9.36 Austrade accepts responsibility for being the catalyst for encouraging companies to trade with Japan. Its objective is to convey current and accurate information about developments in the Japanese economy to Australian exporters as quickly as possible; to help exporters establish more direct lines with customers rather than using intermediaries; to keep them informed about their product in the marketplace and the consequences of any change that is taking place there; and to assist and encourage direct investment in Japan. It supports Australian exporters with their work in regional areas and overall acts as a consultant and adviser to Australian companies doing business with Japanese investments and Japanese companies elsewhere in Asia.³¹

9.37 Mr Dodds told the Committee that, together with the Australian Embassy in Japan, Austrade could help companies seeking to improve their profile in Japan

30 Dr Craig Freedman, *Committee Hansard*, 15 April 1999, p. 351.

31 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 642.

because they have considerable access to the Japanese Government and Japanese industry circles.³²

9.38 Austrade is supported in its work with Australian export companies by other Australian and State Government departments. For example, the Department of Industry, Science and Resources has a resource counsellor attached to the Tokyo Embassy, whose role includes monitoring developments in the energy debate. The counsellor also works closely with the representatives of Australian resources companies in Tokyo, so there is both private and public sector examination of developments in Japan to assess their significance, particularly on demand for resources.³³ In the Department's view:

... there is a very wide range of information available about the situation in Japan—economic, political and social. There is a range of mechanisms, in our department alone, for regular dialogue and consultation with the Japanese on a whole raft of areas. We facilitate high level contacts between businessmen in the two countries and that is complemented by the activities of departments like Foreign Affairs and Trade, which also feed into the information networks available to the government and to business in Australia. I would have thought that Japan would be one of the countries that we almost know the most about in terms of their future trends.³⁴

9.39 The Department also felt confident that the Australian Government and businesses draw on a long history of cooperation with Japan and have proven experience in analysing information coming out of Japan.³⁵

9.40 There is the concern, however, that with a number of Australian Government departments and State Governments working to promote and facilitate trade with Japan their work may unnecessarily overlap. The New South Wales Department of State and Regional Development, however, made clear that Austrade complements and does not duplicate the work that they do in promoting trade in Japan.³⁶ A performance audit by the Auditor-General more generally found that coordination between the Commonwealth and States dealing with export development and promotion services to Australian enterprises is working well but there is room for improvement. In turning to cooperation between Commonwealth agencies it concluded that 'while there was little evidence of the duplication of activities by

32 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 639.

33 Barry Jones, Department of Industry, Science and Resources, *Committee Hansard*, 28 May 1999, p. 694.

34 Barry Jones, Department of Industry, Science and Resources, *Committee Hansard*, 28 May 1999, p. 694.

35 Barry Jones, Department of Industry, Science and Resources, *Committee Hansard*, 28 May 1999, p. 695.

36 David McGeachie, New South Wales Department of State and Regional Development, *Committee Hansard*, 15 April 1999, p. 397.

Commonwealth agencies, weaknesses in coordination present the risk of this occurring'.³⁷

9.41 Clearly, Austrade provides services that Australian exporters value. Mr Pokarier noted its move to give greater emphasis to cost recovery for detailed services to Australian firms and acknowledged that this promotes a better allocation of resources and provides incentive for Austrade to develop competencies through serving a paying clientele. He raised concern, however, that much of the market intelligence gathering is still driven by a 'grab bag' of inquiries that are passed onto the Japanese offices by Australia-based staff. He would like to see the Japanese operations given sufficient resources and discretion 'to explore market opportunities, which having the support of an Australia-based operation...adequately filters inquiries and disseminates new intelligence from Japan to potential as well as existing Australian clients.'³⁸

9.42 One of the problems pointed out by Mr Pokarier is that those Austrade officials who are designated as consuls, carry an enormous responsibility and expectations that go beyond their primary role as trade promoters. He explained that the Japanese understanding of a diplomatic official is one that is quite separate from trade. To meet Japanese expectations, he suggested that the consuls need to have better resources.

We have to allow the consul to do the consular kind of activities and we have to give them more support to also do the trade promotion roles.³⁹

9.43 He submitted further:

It is not surprising that various Japanese organisations will approach the consulates seeking to have the consul carry out various ceremonial functions. School ceremonies are but one example. Such situations may be a great distraction from the task of trade promotion but nonetheless provide an opportunity to foster considerable goodwill between the two nations that might even have some economic pay-offs in the long term. If adequate support is not forthcoming for the consuls to be able to carry out those roles then the Australian Government should investigate the question of designating them simply Trade Representative, although it is recognised that this raises a range of protocol and other issues.⁴⁰

9.44 Austrade has a central role in promoting trade between Australia and Japan. It is aware of its responsibility to keep Australian business fully aware of developments

37 Australian National Audit Office, *Coordination of Export Development and Promotion Activities Across Commonwealth Agencies*, Audit Report no. 39, 1999–2000, Performance Audit, Canberra 2000, pp. 13, 16.

38 Christopher Pokarier, submission no. 10, p. 13.

39 Christopher Pokarier, *Committee Hansard*, 16 April 1999, p. 437.

40 Christopher Pokarier, submission no. 10, p. 14.

in Japan. Mr Richard Pomfret, however, pointed out that although Austrade provides services that exporters value, there is a difficulty in assessing the extent to which its activities actually promote exports.⁴¹

9.45 It is often difficult to measure or quantify the contribution that Austrade makes to trade flows between the two countries. In some cases, Austrade's contribution might have been decisive in securing a contract but in others, it might have just facilitated what was always likely to have been a successful outcome.

9.46 There is also the question of whether Austrade is delivering the best possible results for exporters. According to Austrade's 1998-99 Annual Report, based on an external survey of 2,500 clients, it received a client satisfaction rating of 79.5%. Of those surveyed, 6.5% regarded Austrade's performance as poor or very poor and 14% were either neutral or did not know.

9.47 As the government agency responsible for promoting and facilitating trade with Japan (and all other overseas markets), Austrade needs to ensure that it is doing everything possible to help Australian companies take advantage of all the opportunities for trade and investment that arise from the rapid economic and social change taking place in Japan. As a result, the Committee believes that Austrade should regularly reassess its performance in relation to Japan, in consultation with the Australian business community. When reassessing performance, it should include the following:

- the availability and dissemination of market intelligence;
- the assistance provided to SMEs and whether this takes account of the particular difficulties they experience in securing and maintaining a presence in Japan;
- the level of resources devoted to the Japanese market;
- the opportunities that Austrade has to initiate inquiries rather than respond to requests, keeping in mind potential exporters; and
- the duties expected of Austrade officers in Japan, including the mix of consular activities and trade promotion.

Role of business

Australia's business presence in the region

9.48 One of the main lessons to draw from the evidence presented to the Committee is that there are opportunities waiting to be taken up in Japan but that the onus is ultimately on Australian producers to accept the challenge. This is not to downplay the important responsibility of the Australian Government and its agencies

41 Richard Pomfret, 'Australian Experience with Exporting to Asia', *Seminar Paper 96-0*, Department of Economics and Centre for International studies, University of Adelaide, January 1996, p. 18.

such as Austrade and organisations such as JETRO to predict trends, identify and inform Australians about opportunities and to encourage and finally assist Australian business to make a start in Japan and to maintain their presence there. Government has the important responsibility to listen to Australian business and to help them by clearing away obstacles to trade through negotiated access agreements or similar understandings with Japan. Government also has the responsibility to create within Australia an environment that will assist Australian producers improve their international competitiveness. Ultimately, however, Australian business must set their own course.

9.49 This report has stressed the importance of having a clear understanding of the Japanese consumer, the Japanese business environment, and developments underway in Japan, especially the reform process. The Committee again underlines the message that Australian exporters need to be acutely aware of the changes in the Japanese business world and consumption trends. They need to be able to identify opportunities as they start to emerge in order to promote their interests and reap new rewards. Evidence presented to the Committee, however, shows that Australian producers are not taking full advantage of available resources to acquire the knowledge and expertise needed to effectively exploit the opportunities existing and opening up in Japan.

9.50 JETRO informed the Committee that Australia's performance in using its facilities shows that a gap still exists compared to other countries. It cited Australia's poor interest in the import housing materials exhibition centre as an example of the low level of Australian representation in such promotional schemes. There were only four Australian companies out of a total overseas representation of 544 companies that have exhibited since the centre's inception. Australia's representation was dwarfed by New Zealand's 16 companies.⁴²

9.51 JETRO also referred to its Technology Tie-up Program, which encourages linkages between companies in Japan and overseas in a range of technical fields such as biotechnology, environment technologies and medicine. Canada recorded 111 requests compared to Australia's 17. JETRO suggested that Australian companies may well be hindered in their thinking by perceptions based on past experiences and a limited view of Japan as a low-growth economy. As an indication of this short-term thinking, JETRO has experienced a decline in the number of trade inquiries compared with the situation before the economic crunch. JETRO told the Committee that, through information dissemination, seminars and also through invitations to business people to participate in their various programs, they are trying to erase the notion that Japan offers little promise for business at the moment.⁴³ Austrade was also at pains to

42 Hiroshi Nakano, JETRO, *Committee Hansard*, 3 September 1999, p. 790.

43 Hiroshi Nakano, JETRO, *Committee Hansard*, 3 September 1999, p. 793.

point out that despite talk about Japan's slow-growth economy there are significant areas where consumer demand in Japan is very strong and building.⁴⁴

9.52 Another resource that Australian companies are slow to tap is Japanese language experts. According to Professor Rix, some companies have skilled personnel who can deal with Japan linguistically as well as in a professional capacity, such as Australian mainstream commercial exporters as well as the legal fraternity, the accounting and engineering professions. On the other hand, he pointed out that there are companies dealing with Japan which need more help, who dismiss the importance of speaking Japanese in favour of people who understand the business. He told the Committee that part of the problem is that:

...the Australian private sector still is not as multilingual as it should be. We are still basically going overseas and relying on our own language to get us through. We cannot do that in a complicated market like Japan, which is now looking inward and where we have to fight much harder for market share. That is fundamentally the problem... Within the government you can find people with a strong Japan background and language skills, or if you haven't got those you can get them easily. But in the private sector it is much more difficult.⁴⁵

9.53 He stressed the point that a number of companies still take the view that the Japanese speak English and so it is not an issue. But he emphasised that Australian exporters must do much more at the micro level; that they must deal with the Japanese market on its own terms and not assume that they will do anything to assist exporters.⁴⁶

9.54 Mr Larry Crump, who has lived and worked in Japan as a management and training consultant, went further and suggested that Australian exporters need a class of experts that he called 'Australian-Japanese protocol consultants'. He envisaged a defined position within a relevant organisation whose responsibilities would be to serve as an adviser and consultant to people who are trying to create and enhance organisational relationships with their counterpart in Japan.⁴⁷

9.55 It would seem that one of the underlying difficulties in motivating Australian companies to explore the prospect of trading with Japan stems from their lack of confidence in tackling what they perceive as a difficult place to do business—that Japan is 'too hard'.⁴⁸ To repeat, Mr Dodd's words—the Japanese market has 'most people spooked'.⁴⁹ In part, this perception rests on a lack of understanding of Japan

44 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, pp. 636–7.

45 Professor Alan Rix, *Committee Hansard*, 16 April 1999, p. 448.

46 Gregory Dodds, Austrade, *Committee Hansard*, 27 May 1999, p. 635.

47 Larry Crump, *Committee Hansard*, 16 April 1999, p. 475.

48 See comments by Manuel Panagiotopoulos, *Committee Hansard*, 14 April 1999, p. 228.

49 See chapter 7, para 7.80.

and its market place. As the Committee noted earlier, the Australian Government has a vital role in promoting and facilitating trade with Japan but that the decision to trade with Japan rests inevitably with business.

9.56 The Committee believes, however, that the Government may need to step up its efforts to educate and further encourage Australian business to consider Japan as a viable market. The recommendations put forward by this Committee should go some way to achieving this end.

John Hogg
Chairman

APPENDIX 1

SUBMISSIONS AND SUPPLEMENTARY SUBMISSIONS AUTHORISED FOR PUBLICATION BY THE COMMITTEE

Allen, Professor David, Edith Cowan University, Western Australia (Submission 41)

Askew, Mr David, Department of Japanese Studies, Monash University
(Submission 57)

Australia Japan Housing Ltd (Submission 6)

Australia-Japan Foundation (Submission 37)

Australian Bureau of Agricultural Resource Economics (ABARE) (Submission 21)

Australian Meat Council (Submission 51)

Australian Tourist Commission (Submission 48)

Australian Trade Commission (AUSTRADE) (Submission 35)

Australian Wheat Board Limited (AWB) (Submission 27)

Beeson, Dr Mark, Griffith University, Queensland (Submission 38)

Committee for Economic Development of Australia (Submission 12)

Crump, Mr Larry, Griffith University, Queensland (Submission 52)

Delegation of the European Commission to Australia and New Zealand
(Submission 22)

Department of Employment, Education, Training & Youth Affairs (Submission 16
& 16A)

Department of Foreign Affairs and Trade (Submission 32)

Department of Health & Family Services (Submission 60)

Department of Industry, Science and Tourism (Submission 34)

Department of Primary Industries and Energy (Submission 31)

Department of Social Security (Submission 19)

Department of the Treasury (Submission 63)

Drysdale, Professor Peter, ANU (Submission 61 and 61A)

Freedman, Dr Craig, Macquarie University, NSW (Submission 46)

George Mulgan, Dr Aurelia, ADFA (Submission 20)

Goto, Professor Akira, Visiting Fellow, ANU (Submission 62)

Grains Council of Australia (Submission 24)

Hamersley Iron Pty Limited (Submission 43 and 43A)

Hartcher, Mr Peter (Submission 36)

Hastings Council, NSW (Submission 4)

Japan Chamber of Commerce and Industry (Submission 54)

Japan External Trade Organization (JETRO Sydney) (Submission 64)

Japan International Cooperation Agency (Submission 30)

Japan Local Government Centre (CLAIR Sydney) (Submission 50)

Jones, Mr Peter (Submission 7)

Krishnan, Mr A Radha, Murdoch University, Western Australia (Submission 44)

Lawler, Mr Dwayne (Submission 26)

Lismore City Council, NSW (Submission 11)

McCormack, Profesor Gavan, ANU (Submission 58)

McGarry International Pty Ltd (Submission 14, 14A and 14B)

Miller, Ms Jill (Submission 33)

Morita, Dr Keiko, University of Technology, Sydney (Submission 47)

Morris-Suzuki, Professor Teresa, ANU (Submission 3)

Murray, Mr Stephen (Submission 13)

New South Wales, Cabinet Office, (Submission 25)

Northern Territory, Chief Minister's Office, Darwin (Submission 17)

Osborne Associates (Submission 8)

Panagiotopoulos, Mr Manuel (Submission 9)

Pokarier, Mr Christopher, Queensland University of Technology (Submission 10)

Qantas Airways Limited (Submission 23)

Queensland Government, Department of the Premier and Cabinet (Submission 18)

Queensland Sugar Corporation (Submission 53)

Reid, Professor David, Curtin Business School, Western Australia (Submission 40)

Rice Growers Co-Operative Limited (Submission 56)

Saw James Capel Limited (Submission 42)

Smee, Margaret (Submission 1)

Sone, Ms Sachiko, University of Western Australia (Submission 39)

Steven, Professor Robert, University of NSW (Submission 49)

Sugimoto, Professor Yoshio, La Trobe University, Victoria (Submission 55)

Takao, Dr Yasuo, Curtin University of Technology (Submissions 28 and 29)

Western Australian Treasury (Submission 15, 15A)

Whitehorse City Council (Submission 2)

Woodside Energy Ltd (Submission 45)

Wool Council of Australia and IWS International (Joint Submission) (Submission 5)

Wolff, Mr Leon, ANU (Submission 59)

APPENDIX 2

LIST OF WITNESSES WHO APPEARED BEFORE THE COMMITTEE AT PUBLIC HEARINGS

Monday, 15 February 1999—Canberra

Department of Foreign Affairs and Trade

Mr Derek Brown, Executive Officer, Japan Section
Ms Karen Gilmour, Deputy Director (Economic Section), Japan Section
Mr Colin Heseltine, First Assistant Secretary, North Asia Division
Dr Richard Rigby, Assistant Secretary, North-East Asia Branch
Ms Janet Tomi, Director, China Bilateral Section
Mr John Woods, Director, Japan Section.

Friday, 19 February 1999—Melbourne

Australian Wheat Board Ltd

Mr Simon Burgess, Account Manager, South East Asia
Mr Andrew McConville, Government Relations Manager

Australia-Japan Foundation

Mr Gary Humphries, Project Officer
Ms Gillian Walker, Director (Canberra)
Mr Terrence White, Director

Osborne Associates

Mr Bradley Treadwell, Managing Director

Wednesday, 24 February 1999—Perth*Saw James Capel Ltd*

Mr Owen Clare, Senior Equities Adviser

Mr Kenneth Court

Hamersley Iron Pty Ltd

Mr Philip Mitchell, General Manager, Strategic Marketing

Mr Simon Wensley, Principal Business Analyst

Mr Arun Krishnan, Senior Lecturer in Japanese Studies, School of Asian Studies, Murdoch University

Dr Yasuo Takao, Lecturer, School of Social Sciences and Asian Languages, Curtin University of Technology

Thursday, 25 February 1999—Perth*Treasury Department of Western Australia*

Mr Timothy Marney, Director, Economic Policy

Woodside Energy Ltd

Ms Erica Smyth, Manager Government Approvals

Professor David Reid, MUI Chair of International Business, Curtin University of Technology

Professor David Allen, Professor, Edith Cowan University

Wednesday, 14 April 1999—Sydney*Qantas Airways*

Mr David Callaghan, International Relations Manager

Mr Alan Loke, Group General Manager, North Asia Sales

Mr Damien Wallace, Manager, Network Development

Australian Tourist Commission

Ms Margaret Hudson, Manager Corporate Strategy

Mr Andrew Larcos, Government Relations Officer

New South Wales Minerals Council

Mr Denis Porter, Executive Director

Council of Local Authorities for International Relations

Mr Yoshihiro Tabe, Director, Japan Local Government Centre

Associate Professor Robert Steven Head, School of Political Science,
University of New South Wales

Mr Manuel Panagiotopoulos

Thursday, 15 April 1999—Sydney*Meat and Livestock Australia*

Dr Peter Barnard, General Manager, Economic, Planning and Market
Services

Ms Samantha Jamieson, Manager, market Analysis and Support—Japan

New South Wales Department of State and Regional Development

Mr Perce Butterworth, Executive Director, Policy and Resources,

Mr David McGeachie, General Manager, Trade Services, Trade and
Business Services Division

Australia Japan Housing Ltd

Mr Graham Huxley, Director

Mr Ian McLean, Member

Australian Meat Council

Mr Stephen Martyn, General Manager

Dr Craig Freedman, Director, Centre for Japanese Economic Studies,
Macquarie University

Dr Keiko Morita, Lecturer, Japan Major Coordinator, Institute for International
Studies, University of Technology, Sydney

Mr Peter Hartcher, Asia-Pacific Editor, Australian Financial Review

Friday, 16 April 1999—Brisbane

Department of State Development, Queensland

Mr Philip Henry, Manager, Strategy and Policy Group, Strategic Policy
Division

Mr Philippe Ingram, Manager

Ms Melissa O'Rourke, Senior Policy Officer, Strategic Policy Division

Raw Sugar Marketing, CSR Ltd

Mr Brian Mahony, Marketing Manager

Queensland Sugar Corporation

Mr Warren Males, Principal Economist

QCT Resources Ltd

Dr Christopher Rawlings, Managing Director

Professor Alan Rix, Executive Dean, Faculty of Arts, Professor of Japanese
Studies, University of Queensland

Dr Mark Beeson, Lecturer, Griffith University

Mr Larry Crump, Lecturer, International Management, School of International
Business, Griffith University

Mr Christopher Pokarier

Monday, 17 May 1999—Melbourne*Ricegrowers Cooperative Ltd*

Mr Milton Bazley, Senior Business Manager,

Ms Anne McDonald, Market Intelligence Manager

The Woolmark Company

Mr Christopher Wilcox, Manager, Information and Trade Policy

Professor William Coaldrake, Foundation Professor of Japanese, Melbourne Institute of Asian Languages and Societies, University of Melbourne

Dr Carolyn Stevens, Lecturer in Japanese Studies, Melbourne Institute of Asian Languages and Societies, University of Melbourne

Dr Wendy Smith, Senior Lecturer and Director, Centre of Malaysian Studies, Department of Management, Monash University

Professor Yoshio Sugimoto, School of Sociology, Politics and Anthropology, La Trobe University

Mr David Askew

Monday, 24 May 1999—Canberra

Ms Jill Miller

Professor Teresa Morris-Suzuki

Professor Gavan McCormack

Thursday, 27 May 1999—Canberra*Austrade*

Mr Peter Bergman, National Manager, North East Asia Regional Office

Mr Gregory Dodds, Executive General Manager, North East Asia Regional Office

Mr Brendan Dyson, Manager Japan-Government Relations

Friday, 28 May 1999—Canberra*Department of Industry, Science and Resources*

Mr Daryl Back, Manager, Automotive Section

Mr Craig Burns, General Manager, Minerals Development Branch, Coal and Minerals Division

Mr Ross James, Manager, Investment Policy

Mr Barry Jones, Acting Head, Division of Industry Policy

Mr Jeffrey Riethmuller, Acting Manager, International Sport and Tourism Division,

Mr Donald Smale, General Manager, International Industry Issues Branch, Division of Industry Policy

Mr Peter Van Rens, Assistant Manager, Building and Construction Industry Branch

Mr Warwick Russell, Assistant Manager, Standards and Conformance Policy Section

Department of Agriculture, Fisheries and Forestry—Australia

Dr Dennis Gebbie, Assistant Secretary, International Branch

Ms Judy Barfield, Senior Officer, North Asia Section, International Branch

Mr John Sainsbury, Assistant Secretary, Food and Agribusiness Development Branch, Food and Agribusiness Industries Division

Department of Education, Training and Youth Affairs

Mr Robert Horne, First Assistant Secretary, International Analysis and Evaluation Division

Ms Sara Cowan, Acting Assistant Secretary, International Policy Branch

Ms Rebecca Cross, Assistant Secretary, Australian Education International

Dr Aurelia George Mulgan, Senior Lecturer, School of Politics, Australian Defence Force Academy, University of New South Wales

Mr Leon Wolff, Lecturer, Faculty of Law and Research Fellow, Australia-Japan Research Centre, Australian National University

Monday, 21 June 1999—Canberra*Department of Family and Community Services*

Ms Susan Devereux, Director, International Policy Analysis Section,
Strategic Policy and Analysis Branch

Mr Graeme Hope, Executive Director

Mr Leonard Trainor, Director, Policy Services and Treaties,
International Branch,

Dr Peter Whiteford, Director, Family and Social Analysis, Strategic
Policy and Analysis Branch, Department of Family and Community
Services

Department of Health and Aged Care

Ms Jan Feneley, Acting Assistant Secretary, Office for Older
Australians,

Ms Lana Racic, Director, Older Australians Policy Branch, Office for
Older Australians, Department of Health and Aged Care

His Excellency Mr Aneurin Hughes, Ambassador and Head of Delegation,
European Union

Australian Bureau of Agricultural and Resource Economics

Dr Jammie Penm, Manager, Commodity Forecasting Support Unit

Dr Terence Sheales, Manager, Agriculture and Food Economics Branch

Monday, 23 August 1999—Canberra

Professor Peter Drysdale, Executive Director, Australia-Japan Research Centre,
Australian National University

Professor Akira Goto, Australian National University

Monday, 30 August 1999 (held *in camera*)*Embassy of Japan*

His Excellency, Masaji Takahashi, Ambassador of Japan

Mr Kiyokazu Ota, Minister, Embassy of Japan

Dr Roger Farrell, Adviser

Mr Setsuo Omori, First Secretary

Mr Junichiro Otaka, Second Secretary

Friday, 3 September 1999—Canberra*Japan Chamber of Commerce and Industry, Sydney Inc*

Mr Yasunari Fukuda, Secretary-General,

Mr Fuyuki Kitahara,

Mr John McKindley,

Mr Ryoichi Tsunematsu

Japan External Trade Organisation, Sydney Inc

Mr Hiroshi Nakano, Managing Director

Mr Yasunari Miyauchi, Director, Public Relations and Import
Promotion Department

Mr Matthew Terpstra, Trade Development Officer

Japan Travel Bureau Australia Pty Ltd

Mr Junzo Yamaguchi, Managing Director

Ms Riho Okagami, Assistant General Manager, Corporate Planning

Mr Yasuyuki Okuda, General Manager

Japan Foundation Sydney Language Centre

Mr Katsumi Kakazu, Manager

1964

COMMONWEALTH OF AUSTRALIA

AGREEMENT ON COMMERCE

BETWEEN

AUSTRALIA AND JAPAN

Originally signed on 6th July, 1957 and incorporating amendments, provisionally agreed on 5th August, 1963, and ratified by each Government on 27th May, 1964

By Authority:

A. J. ARTHUR, Commonwealth Government Printer. Canberra

(Printed in Australia)

NOTE

The Agreement on Commerce between the Commonwealth of Australia and Japan was originally signed at Hakone on 6th July, 1957.

The Agreement was reviewed in 1963 and a Protocol of Amendment and other documents were signed in Tokyo on 5th August, 1963. Under an exchange of letters provisional effect was given to these documents pending ratification by both Governments. The documents were ratified in Canberra on 27th May, 1964.

These amendments to the Agreement have been incorporated in the following text.

AGREEMENT ON COMMERCE BETWEEN THE COMMONWEALTH OF AUSTRALIA AND JAPAN

The Government of the Commonwealth of Australia and the Government of Japan,
Being desirous of improving and developing the commercial relations between the two
countries,

Have agreed as follows:

ARTICLE I.

1. With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to the application of internal taxes to exported goods and with respect to all internal taxes or other internal charges of any kind imposed on or in connection with imported goods and with respect to all laws, regulations and requirements affecting internal sale, offering for sale, purchase, distribution or use of imported goods, any advantage, favour, privilege or immunity which has been or may hereafter be granted by the Government of either country to any product originating in or destined for any third country shall be accorded immediately and unconditionally to the like product originating in or destined for the other country.

2. The provisions of paragraph 1 shall not entitle the Government of Japan to claim the benefit of any preference or advantage which may at any time be accorded by the Government of the Commonwealth of Australia to any member country of the Commonwealth of Nations including its dependent territories, or to the Republic of Ireland.

ARTICLE II.

1. No prohibitions or restrictions, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by the Government of either country on the importation of any product of the other country or on the exportation or sale for export of any product destined for the other country unless such prohibitions or restrictions are applied to all third countries.

2. In all matters relating to the allocation of foreign exchange affecting transactions involving the importation and exportation of goods, the Government of each country shall accord to the other country treatment no less favourable than it accords to any third country.

3. Notwithstanding the provisions of paragraphs 1 and 2 either Government may take such measures as are necessary to safeguard its external financial position and balance of payments.

ARTICLE III.

1. With respect to trade between Australia and Japan,

(a) Each Government undertakes that if it establishes or maintains a state trading enterprise, wherever located, or grants to any trading enterprise, formally or in effect, exclusive or special privileges, such trading enterprise shall, in its purchases or sales involving imports or exports, act in a manner consistent with the general principles of non-discriminatory treatment prescribed in this Agreement for governmental measures affecting imports or exports by private traders.

(b) The provisions of sub-paragraph (a) of this paragraph shall be understood to require that such trading enterprises shall, having due regard to the other provisions of this Agreement, make any such purchases or sales solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale, and shall afford trading enterprises of the other country adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales.

(c) Neither Government shall prevent any enterprise (whether or not an enterprise described in sub-paragraph (a) of this paragraph) under its jurisdiction from acting in accordance with the principles of sub-paragraphs (a) and (b) of this paragraph.

2. The provisions of paragraph 1 of this Article shall not apply to imports of products for immediate or ultimate consumption in governmental use and not otherwise for re-sale or use in the production of goods for sale. With respect to such imports, the Government of each country shall accord to the trade of the other country fair and equitable treatment.

ARTICLE IV.

Nothing in this Agreement shall be construed so as to derogate from the rights and obligations that either country has or may have as a contracting party to the General Agreement on Tariffs and Trade, so long as both countries are contracting parties to the General Agreement on Tariffs and Trade.

ARTICLE V.

(Deleted)

ARTICLE VI.

1. Each Government shall accord sympathetic consideration to representations made by the other Government on matters arising out of the operation of this Agreement and shall afford to the other Government adequate opportunity for consultation.

2. Consultation shall in any event be held annually on the operation of this Agreement.

ARTICLE VII.

1. This Agreement shall be ratified by each Government and shall enter into force on the date of the exchange of instruments of ratification.
2. This Agreement shall remain in force until the day three years after the date of the entry into force of the Protocol of 5th August, 1963 amending the Agreement, and shall continue in force thereafter provided that it shall be terminated on that date or thereafter if either Government has previously given to the other Government at least three months' written notice of its intention to terminate the Agreement.

AGREED MINUTES

The representatives of the Government of the Commonwealth of Australia and the representatives of the Government of Japan, confirming that the General Agreement on Tariffs and Trade will be applied between the Commonwealth of Australia and Japan, hereby record the following understandings which have been reached during the course of the negotiations between their respective Delegations leading to the signing today of the Protocol amending the Agreement on Commerce

between the Commonwealth of Australia and Japan, of 6th July, 1957:

PART A

1. (a) The Japanese Delegation stated that the Japanese Government would not discriminate against raw wool, as compared with raw cotton, with respect to non-tariff matters which might affect its importation into Japan.

(b) The Japanese Delegation noted the significance which the Australian Government placed on the continued duty-free import of raw wool into Japan. The Australian Delegation was given to understand that the Japanese Government at this time had no intention of imposing a duty on raw wool, but that this did not in any way bind the Japanese Government legally or morally.

2. (a) In response to a request from the Australian Delegation with respect to the export of soft wheat to Japan, the Japanese Delegation stated that the importation into Japan of Australian soft wheat would continue at a stabilised level. The Japanese Delegation also indicated that it was the intention of the Japanese Government to study with the Australian Government the possibility of bringing the price differential in Japan between Australian F.A.Q. wheat and U.S. Western White wheat down to the differential in world markets.

(b) The Japanese Delegation also stated that the Japanese Government was prepared to purchase Queensland and northern New South Wales hard wheat when the necessary requirements for such purchase were found to have been met.

3. The Japanese Delegation stated that under normal circumstances Japan was now self-sufficient in barley production, but that emergency imports might be necessary from time to time, and confirmed that, with respect to any imports which might be made by the Food Agency, Australian barley would be accorded non-discriminatory access on a most-favoured-nation treatment basis.

4. (a) The Japanese Delegation confirmed that its Government would ensure most-favoured-nation and non-discriminatory treatment in respect of Australian products which were subject to import restrictions in Japan, and stated that it was the intention of its Government to make every effort to expand the opportunities for the import into Japan of the following Australian products: sugar, canned meat, leather, motor vehicles, butter and cheese.

(b) Both the Australian and Japanese Delegations stated that it was the intention of their respective

Governments to maintain the scope of import liberalisation currently in force in their respective countries, and further stated that, if, however, further import restrictions were imposed for balance of payment reasons, they would not be applied so as to prevent

unreasonably the importation of the products concerned in minimum commercial quantities the exclusion of which would impair regular channels of trade.

PART B

(a) Against the background of the overall balance and pattern of trade between the two countries, the Japanese Delegation expressed active interest in the export of Japanese heavy industry products to Australia and requested that, in particular reference to the purchase of goods from abroad by the Australian Government and certain of its Statutory Authorities such as the Snowy Mountains Hydroelectric Authority and the Commonwealth Railways Commissioner for use in their developmental projects, full opportunities of fair competition would be accorded to Japanese products. The Australian Delegation took note of the above statement of the Japanese Delegation and stated that it was the general policy of the Australian Government and the Statutory Authorities named above to call public tenders for their overseas purchases, and further stated that equal opportunities of fair and equal competition were accorded to Japanese products in regard to such tenders.

(b) In regard to such tenders the Australian Delegation further confirmed that upon request by unsuccessful tenderers, explanations of the reasons for failure were given in detail by the Australian Government and the Statutory Authorities named above covering such matters as quality, efficiency of units, conformity with specifications, terms of delivery and servicing or availability of spares, etc., as the case may be and were also given as far as practicable on price.

PART C

(a) The Australian Delegation confirmed that temporary protection under Part V of the Tariff Board Act was applied only when a product was being imported in such quantities or under such conditions as to cause or threaten serious injury to domestic producers of like or competitive products and that such temporary protection was applied only to such extent and for such time as might be necessary to prevent or remedy such injury.

(b) The Australian Delegation confirmed that the Australian Government would, before making a reference to a Special Advisory Authority on items of which Japan was a significant supplier, afford the Japanese Government the maximum practical degree of consultation, and stated that, if the urgency of the matter required a reference before the completion of such consultation, the consultation would be continued, if desired by the Japanese Government after the reference had been made.

(e) The Japanese Delegation confirmed that in the course of such consultation the Japanese Government would be prepared to co-operate with the Australian Government with a view to finding whether the need for action under Part V of the Tariff Board Act could be obviated by measures taken in Japan.

(d) The Australian Delegation confirmed that the practice of its Government in regard to such consultation was, upon receipt of an official application for temporary protection under Part V of the Tariff Board Act, to notify immediately the Japanese Government thereof, and to provide the Japanese Government with such details of the circumstances of the application as were relevant, available and not of a confidential nature in order for the consultation to proceed and that before reaching a decision on action under Part V of the Tariff Board Act, the Australian Government would take full account of any representations made by the

Japanese Government, particularly as to measures taken by Japanese interests to restrict exports to Australia of the items concerned.

(e) The Australian Delegation confirmed that in any reference made to a Special Advisory Authority on items of which Japan was a significant supplier, the Australian Government would continue to seek the advice of a Special Advisory Authority as to whether any temporary protection recommended should apply to products in direct transit to Australia at the date of the reference, and in considering such advice, the Australian Government would continue to pay due regard to the need not to apply such temporary protection unreasonably to such goods.

(f) The Australian Delegation confirmed that in any case where a reference was made to a Special Advisory Authority, the Japanese Government and other Japanese interests would be free to place any information they might so desire before the Australian authorities.

The understandings contained in these Agreed Minutes will, as from the date of the coming into force of the Protocol amending the Agreement on Commerce between the Commonwealth of Australia and Japan of 6th July, 1957 signed today, supersede the understandings embodied in the Agreed Minutes attached to the Exchange of Notes of 6th July, 1957.

EXCHANGE OF LETTERS

I-Iakone

[Translation]

July 6, 1957.

Your Excellency,

With reference to the Agreement on Commerce between Japan and the Commonwealth of Australia signed today, I have the honour to inform your Excellency that the most-favoured-nation provisions of the said Agreement shall not apply to advantages which are accorded or which may be accorded hereafter by Japan to such areas as are set forth in Article 3 of the Treaty of Peace with Japan signed at the city of San Francisco on September 8, 1951, so long as the situation set forth in the second sentence of the said Article continues with respect to the administration, legislation and jurisdiction over those areas.

I have further the honour to request your Excellency to be good enough to confirm the foregoing understanding on behalf of your Government.

I avail myself, Excellency, of this opportunity to extend assurances of my highest consideration.

His Excellency,

J. McEwen,

Minister for Trade,

Commonwealth of Australia.

NOBUSUKE KISHI

Minister for Foreign Affairs

of Japan.

The Minister for Foreign Affairs,

Tokyo.

Hakone

6th July, 1957.

Your Excellency,

I have the honor to acknowledge receipt of your Excellency's Note dated July 6, 1957, which reads as follows:

" With reference to the Agreement on Commerce between Japan and the Commonwealth of Australia signed today, I have the honour to inform your Excellency that the most-favoured-nation provisions of the said Agreement shall not apply to advantages which are accorded or which may be accorded hereafter by Japan to such areas as are set forth in Article 3 of the Treaty of Peace which Japan signed at the city of San Francisco on September 8, 1951, so long as the situation set forth in the second sentence of the said Article continues with respect to the administration, legislation and jurisdiction over those areas.

I have further the honour to request your Excellency to be good enough to confirm the foregoing understanding on behalf of your Government."

On behalf of the Government of the Commonwealth of Australia I have the honour to confirm the understanding stated in your Excellency's Note with respect to the application of the Agreement on Commerce between the Commonwealth of Australia and Japan signed today to the areas specified in Article 3 of the Treaty of Peace with Japan.

I avail myself, Excellency, of this opportunity to renew assurances of my highest consideration.

J. McEWEN,
Minister for Trade.

The Minister for Foreign Affairs,
Tokyo.

Hakone
6th July, 1957.

Your Excellency,

With reference to the Agreement on Commerce between the Commonwealth of Australia and Japan signed today, I have the honour to inform your Excellency that the provisions of this Agreement shall not apply to any of the external territories administered by the Government of the Commonwealth of Australia nor to any advantages which are accorded or which may be accorded hereafter between the external territories and the metropolitan territory of Australia.

I have the honour to request your Excellency to be good enough to confirm the foregoing understanding on behalf of your Government.

I avail myself, Excellency, of this opportunity to renew assurances of my highest consideration.

J. McEWEN,
Minister for Trade.

[Translation]

Hakone
July 6, 1957.

Your Excellency,

I have the honour to acknowledge receipt of your Excellency's Note dated July 6, 1957, which reads as follows:

" With reference to the Agreement on Commerce between the Commonwealth of Australia and Japan signed today, I have the honour to inform your Excellency that the provisions of this Agreement shall not apply to any of the external territories administered by the Government of the Commonwealth of Australia nor to any advantages which are accorded or which may be accorded hereafter between the external territories and the metropolitan territory of Australia.

I have the honour to request your Excellency to be good enough to confirm the foregoing understanding on behalf of your Government."

On behalf of the Government of Japan I have the honour to confirm the understanding stated in your Excellency's Note with respect to the application of the Agreement on Commerce between Japan and the Commonwealth of Australia signed today to the external territories administered by the Government of the Commonwealth of Australia.

I avail myself, Excellency, of this opportunity to renew assurances of my highest consideration.

His Excellency,

J. McEwen,
Minister for Trade,
Commonwealth of Australia.

NOBUSUKE KISHI,
Minister for Foreign Affairs
of Japan.

Tokyo
5th August, 1963.

Your Excellency,

On the occasion of the signing today of the Protocol amending the Agreement on Commerce between the Commonwealth of Australia and Japan of 6th July, 1957. I have the honour to inform you that the Government of the Commonwealth of Australia will, on the date of the entry into force of the above-mentioned Protocol, cease to invoke Article XXXV of the General Agreement on Tariffs and Trade against Japan.

A copy of this Note is being forwarded to the Executive Secretary of the General Agreement for the information of the Contracting Parties.

I avail myself, Excellency, of this opportunity to extend assurances of my highest consideration.

His Excellency,

Mr. Hajime Fukuda,
Minister for Foreign Affairs *ad interim*,
Minister of State of Japan.

J. McEWEN,
Minister for Trade,
Commonwealth of Australia.

Tokyo

5th August, 1963.

Your Excellency,

I have the honour to acknowledge receipt of your Note of 5th August, 1963 which reads as follows:

" On the occasion of the signing today of the Protocol amending the Agreement on Commerce between the Commonwealth of Australia and Japan of 6th July, 1957, I have the honour to inform you that the Government of the Commonwealth of Australia will, on the date of the entry into force of the above-mentioned Protocol, cease to invoke Article XXXV of the General Agreement on Tariffs and Trade against Japan.

A copy of this Note is being forwarded to the Executive Secretary of the General Agreement for the information of the Contracting Parties."

I avail myself, Excellency, of this opportunity to extend assurances of my highest consideration.

His Excellency,

Mr. J. McEwen,

Minister for Trade,

Commonwealth of Australia.

HAJIME FUKUDA,

Minister for Foreign Affairs *ad interim*

Minister of State of Japan

Tokyo

5th August, 1963.

Your Excellency,

I have the honour to refer to the documents mentioned hereunder which have been signed today by us:

- (1) Protocol amending the Agreement on Commerce between the Commonwealth of Australia and Japan;
- (2) Agreed Minutes.

The agreements and understandings between our two Governments embodied in these documents will come into force on the date of the entry into force of the Protocol mentioned in (1) above.

In view of the desirability of putting into operation, as soon as possible, the agreements and understandings embodied in these documents, my Government proposes that, pending the entry into force of the above-mentioned agreements and understandings, our two Governments give provisional effect, within the limits of their constitutional authority, to these agreements and understandings as from today on the understanding that such provisional effect may be terminated by either Government subject to three months prior notice in writing.

If the above proposal is acceptable to your Government, I have the honour to suggest that the present Note and your Excellency's reply to that effect shall be regarded as constituting an agreement between our two Governments which shall enter into force oil today's date.

I avail myself, Excellency, of this opportunity to renew assurances of my highest consideration.

His Excellency,

Mr. J. McEwen,
Minister for Trade,
Commonwealth of Australia.

I-IAJIME FUKUDA,
Minister for Foreign Affairs *ad interim*
Minister of State of Japan.

Tokyo

5th August, 1963.

Your Excellency,

I have the honour to acknowledge receipt of your Excellency's Note of 5th August, 1963 which reads as follows:

" I have the honour to refer to the documents mentioned hereunder which have been signed today by us:

- (1) Protocol amending the Agreement on Commerce between Japan and the Commonwealth of Australia;
- (2) Agreed Minutes.

The agreements and understandings between our two Governments embodied in these documents will come into force on the date of the entry into force of the Protocol mentioned in (1) above.

In view of the desirability of putting into operation, as soon as possible, the agreements and understandings embodied in these documents, my Government proposes that, pending the entry into force of the above-mentioned agreements and understandings, our two Governments give provisional effect, within the limits of their constitutional authority, to these agreements and understandings as from today oil the understanding that such provisional effect may be terminated by either Government subject to three months prior notice in writing.

If the above proposal is acceptable to your Government, I have the honour to suggest that the present Note and Your Excellency's reply to that effect shall be regarded as constituting an agreement between our two Governments which shall enter into force oil today's date."

On behalf of the Government of the Commonwealth of Australia, I have the honour to accept the proposal contained in your Excellency's Note with respect to the provisional application of the agreements and understandings embodied in the documents listed, signed by us today, and to accept the suggestion that your Excellency's Note and my reply shall be regarded as constituting ail agreement between our two Governments entering into force oil today's date.

I avail myself, Excellency, of this opportunity to renew assurances of my highest consideration.

His Excellency,

Mr. Hajime Fukuda,

Minister for Foreign Affairs *ad interim*

Minister of State of Japan.

J. McEWEN,

Minister for Trade,

Commonwealth of Australia.



SUBMISSION OF THE AUSTRALIAN GOVERNMENT TO THE JAPANESE GOVERNMENT ON THE DEREGULATION PROMOTION PROGRAM

The Australian Government welcomes this further opportunity to make a submission to the Government of Japan in preparation for the first revisions to the Deregulation Promotion Program (1998-2000).

Australia sees the announcement of the Deregulation Promotion Program as a demonstration of the Japanese Government's continuing commitment to liberalisation of the Japanese economy. Liberalisation—and the efficiency gains it leads to—has the potential to bring about significant improvement in Japan's economic outlook, particularly in the medium and long term. A more competitive and steadily growing Japanese economy is also an important factor in reviving those economies in the Asian region which have been confronted with financial and economic turmoil over the last twelve months.

A vigorous deregulation program is an essential complement to the Japanese Government's macro-economic policies and can contribute directly to increases in consumer demand.

This submission contains details of regulatory issues which either directly or indirectly affect access to the Japanese market by Australian companies. The Australian Government has previously raised most of these issues with the Japanese Government, either in its submissions to the Deregulation Committee, or in other forums, or directly with the Japanese Government Agencies concerned. Some of the requests have been refined to take into account improvements which the Japanese Government has introduced—Australia welcomes all such improvements.

Australia looks once again to the Japanese Government to continue its efforts to liberalise the Japanese economy and in doing so, to return to a period of steady, sustainable growth. Australia hopes this will allow Australia's trade relationship with Japan to expand and diversify even further.

**SUBMISSION OF THE AUSTRALIAN GOVERNMENT
TO THE JAPANESE GOVERNMENT ON
THE DEREGULATION PROMOTION PROGRAM**

CONTENTS

- I. HOUSING AND CONSTRUCTION
- II. TELECOMMUNICATIONS
- III. AGRICULTURAL PRODUCTS
- IV. OTHER

I. HOUSING AND CONSTRUCTION

1. Development of performance-based standards

Problem

Australia notes that the Ministry of Construction (MOC) is working to establish a new regulatory framework by 2000 that accommodates performance based standards. The implementation and subsequent application of these new standards will not automatically address the concerns raised under previous submissions.

Australia would welcome the continued close dialogue on the implementation and application of the new regulatory framework through the Japan Australia Building Housing Committee, including areas such as steel-framed housing.

Request

That the relevant design guidelines and regulations under the Building Standard Law of Japan be amended to ensure that design criteria give effect to the principle that all houses be designed to the same performance-based standards, regardless of construction materials used.

2. International Harmonisation of Standards

Problem

Guidelines issued by Japan's Government Home Loan Corporation (GHLC) require the use of Japan Agricultural Standards (JAS) accredited materials, or materials graded according to North American standards, in order to qualify for GHLC financing.

Given the important role GHLC has in providing housing finance in Japan, the current policy limits access for foreign building products to those which have been accredited with the JAS mark.

Requests

- (i) That Japan accept Australian timber grade stamps and quality assurance systems as complying with the GHLC guidelines. Australia is currently conducting a research program that will demonstrate how Australian timbers comply with these guidelines.
- (ii) That Japan accept product certification marks from Australian third-party product certification bodies that are accredited under the accreditation rules of the Joint Accreditation System of Australia and New Zealand (JAS-ANZ).

3. Steel-framed Housing

Problem

The Ministry of Construction publication, 'Performance Evaluation and Appraisal Standards for Steel House Structures' indicates that steel with a thickness of 0.8mm to 2.3mm will now be considered under Japanese regulations for inclusion in Japanese houses. While this development is welcomed by Australia, Japanese regulations still preclude from consideration many steel structural sections commonly used in Australian framing. Many Australian companies are using new, innovative steel technologies which allow for much lower thicknesses (e.g. 0.4 mm is used in some frames), but exhibit the strength and quality characteristics of much thicker steel.

The above-mentioned publication also states that the 400 N/mm² steel grade shall be the standard of strength classification in Japan.

These non-performance-based restrictions decrease the range of cost-effective building materials available to the Japanese builder and consumer, thereby unnecessarily increasing costs.

Requests

- (i) That the relevant design guidelines and regulation under the Building Standard Law of Japan stipulating allowable steel frame sections be amended to focus on the *performance of steel sections*, rather than on their thickness.
- (ii) That regulations stipulating a 400 N/mm² standard strength classification be replaced by a performance-based assessment of steel strength-performance.

II TELECOMMUNICATIONS

Australia welcomes the Japanese Government's efforts to liberalise the telecommunications sector in Japan, but has identified a number of features of the regulatory regime in Japan which make it difficult for new entrants to do business in Japan. Following is an outline of regulatory issues which have made market entry difficult for Australian firms.

1. Requirement to hold two authorisations

Problem

Under the Telecommunications Business Law (TBL) a Type 1 holder provides telecommunications services using facilities established on its own. A Type 2 registration holder provides telecommunications services by leasing circuits and facilities from Type 1 telecommunications businesses.

This means that a Type 1 licence holder may not lease telecommunications lines or circuits to provide its services. To provide Type 1 services where it does not own any circuits, it is necessary for a Type 1 licensee to enter into an interconnection agreement with other Type 1 licensees or to entrust such services to other entities. However, such entrustment may be made only in limited instances set out in Ministry of Posts and Telecommunications (MPT) internal guidelines and requires the prior authorisation of the MPT.

In addition, a single entity may only hold one authorisation, namely, a Type 1 licence or a Type 2 registration.

For new entrants these requirements create market access barriers. Most new entrants would seek to provide services using facilities they would purchase, lease or access from other telecommunications operators. Under the current regulatory regime, such operators would be required to obtain and maintain two authorisations, namely, a Type 1 licence and Type 2 registration (and current regulations would not permit holding both authorisations, in any event).

Request

That Japan eliminate the Type 1/Type 2 distinction, so that a telecommunications operator only had to obtain and maintain one licence. This could be achieved by allowing the holder of a Type 1 licence to carry out all the activities a Type 2 registration holder can, including leasing facilities. The Type 1 licence holder would still be required to establish some facilities of its own but would be allowed greater flexibility in establishing, as opposed to leasing, its facilities. The Type 2 registration could remain unchanged, allowing those operators which do not wish to establish facilities to provide services through the facilities of others.

Alternatively, if the more expansive rights under a Type 1 licence were not granted, it would assist if one entity could hold 2 authorisations, a Type 1 licence and Type 2 registration. Maintaining two separate entities so that each one can hold one authorisation is a significant barrier to entry into the market.

2. Subsequent MPT approvals and requirements

Problem

Under the TBL range of agreements, customer contracts and procedures require either notification to or approval by the MPT prior to the commencement of services. The requirements vary according to the type of authorisation the provider of the services holds. However, these requirements create another administrative layer for operators, and potentially can delay service offering and service innovation.

Request

Australia recommends that the MPT review these requirements and their objectives with a view to reducing and streamlining the requirements.

3. Guidelines not centrally located or indexed

Problem

Australian industry considers that the TBL, and the guidelines issued by the MPT to assist in explaining the TBL are often difficult to understand. Moreover, it seems that in addition to the written rules - there are a large number of unwritten internal MPT guidelines which are not promulgated.

The MPT guidelines are not centrally located or indexed. Australian industry has often proceeded with its analysis of the TBL, ignorant of relevant MPT guidelines. It has often found out about guidelines from third parties, and at a late stage of its analysis of the TBL.

In addition, Australia would encourage transparency in the review of the TBL and in its implementation. The Australian government recommends that the Japanese Government adopt "notice and comment" procedures for proposed changes to the TBL and its implementation. Such mechanisms should be open to all interested parties, including existing and potential operators and consumers. To ensure that all interested parties are aware of proposed changes, Australia recommends that a variety of notice procedures be used, e.g., web sites, industry circulars, direct notice to registered operators. This should help to ensure that the needs of all interest groups are met and that the regulatory regime encourages innovation, competition and consumer benefits.

Requests

- (i) That the guidelines explaining the TBL should be centrally located, indexed, and readily available, e.g., on the MPT web site. It would be helpful if an English version of the guidelines or an index could be provided.
- (ii) That the Japanese Government adopt transparent procedures in reviewing the TBL and its implementation.

4. Problems in communicating with the MPT

Problem

The process for communicating with the MPT and seeking industry views on the TBL is costly and causes delays. The MPT usually prefers that formal meetings are arranged at the MPT in Tokyo to discuss issues and lodge documents. Such procedures are especially cumbersome for foreign companies whose regulatory teams are based overseas.

Request

That the MPT provided a telephone, fax or email service where operators could ask questions. This would assist both local and foreign operators.

5. Unclear administrative requirements

Problem

Representatives of Australian companies in Japan have frequently encountered considerable difficulty in obtaining clear advice from the MPT. For example, under the TBL a Type 1 licence holder provides telecommunications services using "facilities established on its own". Australian industry is not certain what "established on its own" means, despite considerable discussion with the MPT. Australian industry has also heard conflicting views on the requirement that an entity may only hold one authorisation. This has created considerable uncertainty in respect of Australian industry's network and regulatory requirements.

In response to inquiries through its local lawyers, the MPT has recommended that Australian carriers submit draft applications for the MPT to review. The MPT would then respond by indicating whether the application is satisfactory or by pointing out what is wrong with it. This is not entirely satisfactory. Operators need to understand the regulatory regime so they can make business decisions about what network infrastructure they require, what services they can provide etc., ahead of submitting a licence application.

Request

That the MPT issue written responses to inquiries. Such responses would assist in clarifying the operation of the TBL. The Australian government acknowledges that a formal written response to all inquiries could place a large strain on MPT resources. However, some capacity for formal responses on key issues would assist operators.

6. Interconnection

Problems

Under the TBL, approval for interconnection arrangements and obtaining a Type 1 licence are interdependent, i.e., you can not obtain one without the other. This requirement causes administrative difficulties.

Under the current interconnect arrangements, NTT requires that operators establish separate interconnect lines for separate services.

Requests

- (i) Australia recommends the removal of the interdependency of agreeing interconnect arrangements and holding a Type 1 licence. The same effect could be achieved by providing that an operator could only provide services under an interconnect agreement if it holds a valid licence or registration.
- (ii) That the Japanese government permit an operator to establish a single interconnect line with NTT for a range of services. These services would be mixed and then split into separate services at the NTT exchange.

III AGRICULTURAL PRODUCTS

1. *Rice*

Problem

Australia is concerned at continued difficulties faced in obtaining commercial access to the Japanese market.

Australia acknowledges that Japanese officials have increased the quantity available under the May 1998 SBS tender which allows Japanese consumers greater access to fresh Australian rice. However, this represents only a small proportion of Japan's WTO import commitments (10% of total imports in 1997).

A further increase in the quantity available under SBS tenders conducted early in the Japanese fiscal year and the earlier scheduling of some minimum access tenders would provide benefits for Japan and Australia. It would provide more orderly distribution and allow Japanese consumers access to fresh new season rice twice in the same year. It would also benefit Australia, which is the only supplier with freshly harvested rice available early in the marketing season.

The potential for regular use of imported minimum access rice to meet Japanese Food Aid commitments is also a major concern. While the Australian government appreciates the humanitarian reasons involved, the agreement by WTO members to allow Japan to delay implementation of tariffication of its rice policies during the Uruguay Round was on the expectation that imported rice would gain genuine access to the Japanese market, i.e. private consumers. The use of imported rice for Food Aid shipments without ever having genuine free access to the Japanese market undermines this outcome, and is contrary to the spirit of the Uruguay Round agreement.

Requests

- (i) That Japan review its timing, pricing and distribution arrangements for imported rice, particularly under minimum access tenders, to provide a reasonable level of access to the domestic market across the Japanese fiscal year. As part of this process, the Japanese Government should further increase access under SBS tenders conducted early in the Japanese fiscal year.
- (ii) That Japan reconsider its policy of using minimum access rice in its food aid program.

2. *Sugar*

Problem

The wedge between world prices and the Japanese domestic price is supported by the Sugar Price Stabilisation Law, which features levies, a sliding scale of surcharges and rebates. This is used to support domestic prices.

For imported sugar, each importer is required to sell all of the imported sugar to the Agriculture and Livestock Industries Corporation (ALIC) at the average import price current at the time an import declaration is made. Simultaneously, the Corporation sells the same sugar back to the same importer at an adjusted price, after the addition of levies and surcharges, or the deduction of rebates. This places sugar at a price disadvantage compared to non-sugar sweeteners.

Request

That Japan make further general reductions in its domestic target price for domestic sugar through reductions in the tariff, rate of surcharge and rate of levy. This would stimulate Japanese consumption and benefit the Japanese refinery and Australian raw sugar industries.

3. State Trading

Problem

State trading monopsony importers such as the Food Agency have price setting authority (including import mark-ups) and shield consumers from the potential benefits of liberalised trade. Moreover, the Food Agency and, to a lesser extent, the ALIC, continue to administer "in-quota" imports with wide discretionary powers following the Uruguay Round agreements. In particular, these include direct control over all staple foods, including rice, wheat and other grains through the Japanese Food Agency and quota controls (for example, on dairy products) through the ALIC.

The intervention of these agencies in the market place adds an unnecessary barrier between foreign suppliers and the consumer market, and maintains an often large gap between domestic consumer prices and world prices.

Requests

- (i) That Japan deregulate further the operations and management of agricultural trade by the Food Agency and, where relevant, the ALIC.
- (ii) In the interim, that Food Agency activities should reflect, to the fullest extent possible, prevailing market forces. Specifically, they should take steps to eliminate the gap between domestic consumer prices and world prices.

4. Recognition of further non-quarantine pests

Problem

Australia welcomes changes to the Japanese Plant Protection Law that provide for recognition of non-quarantine pests of plants and plant products. This is consistent with Japan's obligations under the International Plant Quarantine Convention and relevant international phytosanitary standards recognised by the WTO/SPS Agreement.

The legislation currently includes a list of 36 pests, although the Japanese government has recently proposed to add a further 27 pests by the end of this year. Japan's 1998 Deregulation

Promotion Program acknowledged the need to expand further the list of non-quarantine pests. Australia endorses this initiative, and believes that further expansion of the list will assist in relieving unjustified technical restrictions (i.e. unnecessary commodity treatments) currently placed on certain imports of plants and plant products from Australia and elsewhere.

However, Australia believes that the current legal and administrative arrangements for expanding the list are too inflexible. An appropriate administrative mechanism should be adopted to enable the non-quarantine pest list to be updated easily, without requiring a ministerial directive and subsequent changes to the Plant Protection Law. In Australia's case, the plant quarantine law provides for a codified process to be administered by officials in identifying candidate non-quarantine pests. Officials are required to use pest risk analysis procedures, which are technically based, transparent, and subject to comment by interested parties.

Requests

- (i) That Japan review the legal and administrative procedures currently used to expand the non-quarantine pest list. Specifically, that Japan remove the requirement for a ministerial ordinance to change the list, and adopt a codified and transparent administrative mechanism for this purpose.
- (ii) Australia encourages Japanese officials to use internationally accepted pest risk analysis standards to identify further non-quarantine pests and to examine the current list more efficiently and in a publicly available format.

IV OTHER

1. Access for Australian Thoroughbred Racehorses

Problem

Access to the Japanese market for Australian race horses is restricted in a number of ways, including by the application of discriminatory (non-national treatment) policies by the Japan Racing Association (JRA).

The authority of the JRA to implement such policies stems from a statutory delegation of power by the Japanese government in accordance with the provisions of the Japan Racing Association Law. According to Article 8 of this law, rules concerning implementation of horse racing and registration of horse owners must be approved by the Minister of Agriculture, Forestry and Fisheries. Also, Article 18 (2) of the Horse Racing Act stipulates that the Minister for Agriculture, Forestry and Fisheries may order the JRA to suspend "central horse races" in the case of violation of the Act or the relevant orders under the Act.

JRA policies are in effect government regulations, and as such, should be subject to the same basic principles favouring deregulation and market access which have been announced by the Japanese government.

JRA policies currently limit the number of races which are open to foreign-bred horses. Under these policies, in 1998 foreign-bred horses:

- which were stabled in Japan and which had not raced overseas were only allowed to race in 52% of JRA races ("mixed races"), which should increase to 55% in 1999;
- which had raced outside of Japan were only allowed to participate in 11 races ("international races") per year.

Race horse owners who are not residents of Japan are prevented by JRA policies from registering with the JRA. Under Article 13 of the Horse Race Act, owners who are not registered with the JRA are not able to enter their horses in races organised by the JRA ("central horse races").

Requests

- (i) That Japan eliminate all restrictions on foreign-bred racehorses' participating in races controlled by the JRA.
- (ii) That the JRA review the rules concerning the registration of racehorses in Japan in order to allow foreign owners to set up and operate stables in Japan. Specifically, that the JRA eliminate the rules preventing non-residents from registering with the JRA and the rules preventing the racing of horses in Japan by non-residents.

2. Legal Services

A: Restriction on advising on third country law

Problem

As a result of recent changes to Japanese legislation, registered foreign legal consultants are permitted to advise on third country law with written advice from foreign lawyers qualified in that third country. These recent amendments were intended to liberalise the rules governing the provision of advice on third country law by foreign legal consultants. However, it is not clear why foreign legal consultants should be subject to any restrictions on advising on third country law to which Japanese lawyers are not subject, particularly as neither may have qualifications in the law of that third country. Accordingly, the conditions for foreign legal consultants to advise on third country law should be made the same as the conditions for Japanese lawyers.

Request

That registered foreign legal consultants be permitted to advise on third country law on the same basis as Japanese lawyers.

B: Experience requirements for foreign legal consultants

Problem

Recent legislative changes reduced the experience required to register as a foreign legal consultant from five to three years, while at the same time reducing the amount of time spent in Japan that would count toward meeting that requirement from two years to one year. In gaining the experience necessary to qualify as a foreign legal consultant, lawyers can benefit from working under the supervision of a lawyer from their home jurisdiction, regardless of whether they are working in their home jurisdiction or elsewhere. For this reason, people attempting to qualify as registered legal consultants in Japan should be given credit for *all* experience gained working under the supervision of a lawyer from their home jurisdiction.

Recent amendments to Japanese legislation permit a foreign lawyer to count toward meeting the experience required to register as a foreign legal consultant the time spent practising the law of the lawyer's home jurisdiction in a third country. Against this background, the one year maximum now permitted for work experience in Japan should be removed, and *all* experience gained working in Japan under the supervision of a lawyer from a person's home jurisdiction should be able to be counted.

Despite these changes, however, it would seem that the additional experience requirements in Japan to practise home country law should be removed, particularly

where there is no such requirement in the foreign legal consultant's home jurisdiction. In the case of Australia, if a lawyer has an unrestricted practice certificate to practise the law of Australia, it does not seem reasonable that there should be further experience requirements to practice that same law, regardless of where that law is being practised.

Requests

- (i) That Japan recognise the experience gained in a foreign lawyers' home jurisdiction to acquire an unrestricted practising certificate as sufficient for the purposes of gaining registration to practice the law of that home jurisdiction in Japan.
- (ii) Failing such recognition, that where a lawyer applies for registration in Japan to practice law which applies in a foreign country then that lawyer may be credited with experience gained in Japan under the supervision of a lawyer from that foreign country.

3. Financial Services

Problem

Australia welcomed the commitments on market access made by Japan at the conclusion of the 1997 WTO financial services negotiations. However, a number of requests made by Australia remain unaddressed by Japan. There are also existing impediments to competition by foreign firms in the Japanese market which are largely the result of slow and cumbersome Japanese regulatory processes.

Requests

- (i) That Japan meet Australia's outstanding requests, and formalise the results of regulatory reform of the financial system including on the following matters:
 - Deregulation of foreign exchange controls.
 - Moves to remove barriers to banks, securities and insurance companies competing in each others' main business areas. The law to implement these reforms was passed on 5 June 1998 and the reforms will come into effect by the end of March 2001. At present there is some scope for these financial services companies to enter each others' business areas through financial holding companies.
 - Moves to lower barriers separating commercial banks, long term credit banks and trust banks. A law which will permit each type of bank to possess subsidiaries that are engaged in other banking business will come into effect from 1 December 1998.

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- (ii) The Australian government also seeks further improvements to the product approval process. Although it appears that applications are now to be processed within 90 days from the date of acceptance, clear criteria nonetheless need to be developed as to what constitutes "acceptance" in the opinion of the relevant authorities. To date Japan has not responded to this request.
- (iii) Finally, that Japan make a real and substantial commitment to competition principles, taking appropriate measures to prevent anti-competitive practices.

4. Fast Ferries

Problem

Approximately 90 per cent of Australian production of high speed aluminium ferries is now exported with Australia holding 40 per cent of the world market.

Despite its success, Australia has sold very few high speed fast ferries to Japan. While it is the leading supplier to the international car ferry market, Australia has not been successful in winning any tenders in Japan in this category. At the same time, Japan has not been able to sell a single domestically-produced car ferry overseas.

The Australian marine industry and the Australian Government obtained significant dispensation from the requirements of the Japanese Maritime Credit Corporation (MCC, as it then was) during 1996-7. While these concessions are welcome, it would appear that non tariff activity in the Japanese market remains.

This is evidenced in non-tariff 'disincentives' administered by Japanese regulatory bodies for example:

- . no mutually agreed English translation of the Corporation for Advanced Transport and Technology (CATT) quality standards
- difficulties have arisen when relying on translations that the CATT has not verified;

Request

That the CATT provide a standard English translation of all contractual documents, including the relevant quality standards.